

THE UNIVERSITY OF NEW SOUTH WALES



Faculty of
Commerce and Economics

School of Accounting

ACCT 3708
AUDITING AND ASSURANCE SERVICES

COURSE OUTLINE

Session 2, 2004

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***Note: Monday 4 October is a Public Holiday**

THE UNIVERSITY OF NEW SOUTH WALES
SCHOOL OF ACCOUNTING
ACCT3708 AUDITING AND ASSURANCE SERVICES
SESSION 2 2004
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:

CPA Australia and the Institute of Chartered Accountants in Australia, Auditing Handbook, 2004, Vol. 2 of the Accounting and Auditing Handbook, Prentice-Hall.

Gay G., & R. Simnett "Auditing and Assurance Services in Australia" (2nd Edition) McGraw-Hill, Sydney 2003. Note : This text is available as a package with the "MaxMark" student resource which includes a test bank of multiple choice questions.

P. Roebuck & N. Martinov "Case Studies in Auditing & Assurance" (3rd Ed.) Butterworths, 2003.

(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 reserve.)

5. Assessment:

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

Workshop Quiz (Week 5)	5%
Mid-Session Test (Week 8)	25%
Assignment (Weeks 6 and 11)	20%
Final Examination	50%
	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 8 on Friday 17 September and will cover all material up to and including week 6 (workshop 5). Location and timing of the Exam will be advised 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. This exam will be held on Monday 13 December. Note that it is university policy to advise the granting of supplementary exams via your student email address.

Assignment:

The assignment is a group project and will require a written submission. Students will be allocated into groups of four during the first few weeks of the session. The marks allocated will include a peer assessment component to ensure that each individual's input into their group assignment is adequately reflected in the final mark. The assignment will be collected in two stages, in Week 6 and in Week 11.

6. Staff:

Staff participating in this course are:

	Room	Telephone	Email
Wendy Green (Lecturer-in-charge and Honours Co-ordinator)	Quad Room 3094	9385 5805	w.green@unsw.edu.au
Nonna Martinov	Quad Room 3101	9385 5940	n.martinov@unsw.edu.au
Stuart Taylor	Quad Room 3092	9385 5826	stuart.taylor@unsw.edu.au
Fiona Foster	Quad Room 3113	9385 5907	f.foster@unsw.edu.au
Tatjana Lovelady	Quad Room 3113	9385 5907	t.lovelady@unsw.edu.au

Staff consultation hours will be advised in workshops. Note that consultation in person is the recommended consultation mode. Any problems should be directed in the first instance to your workshop leader.

7. Attendance at Classes

Students are expected to regularly attend workshops, which form an integrated sequence of topics, with each week drawing and building upon previous topics. Therefore, failing to keep up to date with the workshop material will place you at a significant disadvantage.

You should consult your workshop leader if you are to be absent for an extended period of time.

Students should also be aware that University regulations indicate that students who do not attend 80% of scheduled classes may not be awarded a pass in the course.

8. Student Conduct and Behaviour

Students are expected to conduct themselves with consideration and respect for the needs of fellow students and teaching staff. This includes **prompt arrival at workshops** and **avoidance of disruptive behaviour**. Included in disruptive behaviour is talking during lecture segment of the workshops and the ringing or use of mobile phones.

Students will be given one warning by teaching staff if their behaviour affects the participation of others in the workshop.

9. Keeping Informed

Students should take note of any announcements made in workshop; on the course website or via group email to your student email address. Students will be deemed to have received these announcements.

10. 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.mhhe.com/au/gay2e>. The site contains information for students such as an On-line Learning Centre, Weblinks and an Auditing News Centre.

11. Learning Centre

The Learning Centre provides a free and confidential service offering learning and language support to UNSW students. Assistance is provided through workshops, discipline-based courses and individual consultations. The Learning Centre can be contacted on 9385-3890.

12. Education Development Unit

Additional learning and language support or a 'discipline-specific' support class can be arranged with the Education Development Unit (EDU) in the Faculty. Students may consult the EDU for advice and assistance with assignment writing, academic reading and note-taking, oral presentation, study skills or other learning needs. The Unit is located in Level 2, South Wing, Quadrangle Building; phone 9385-6163 or 9385-6087.

The EDU workshop schedule for Semester 1, 2004, can be found at:

<http://education.fce.unsw.edu.au/undergraduate/workshoptimetable.html>

13. Counselling Service

Counsellors offer assistance in planning, decision-making, problem solving, and social and emotional development. The Counselling Service is located at Level 2, East Wing, Quadrangle Building; phone 9385-5418.

14. Academic Misconduct

Students are reminded that the University regards academic misconduct as a very serious matter. Students found guilty of academic misconduct are usually excluded from the University for two years. However, because of the circumstances in individual cases, the period of expulsion can range from one session to permanent expulsion from the University.

The following are some of the actions which have resulted in students being found guilty of academic misconduct in recent years:

- taking unauthorised materials into an examination;
 - submitting work for assessment knowing it to be the work of another person;
 - improperly obtaining prior knowledge of an examination and using that knowledge in the examination; and
 - failing to acknowledge the source of material in an assignment.
-

CLASS TIMETABLE - PROVISIONAL

ACCT3708 Auditing and Assurance Services	L/T Class No.	Day	Time	Room Size	Location
Lectures in Week 1 only	Lect a 3421	thu	12:00 - 13:00		Bid placed
	or				
	Lect b 3507	thu	19:00 – 20:00	45	As above
Tutorials start in week2	t1	mon	13:00 - 16:00	30	WEBSTER251
	T2	mon	17:00 - 20:00	36	WEBSTER250
	T4	tue	10:00 - 13:00	30	OMB 229
	T5	tue	13:00 - 16:00	40	AS 713
	T6	wed	10:00 - 13:00	40	WEBSTER251
	T7	wed	13:00 - 16:00	40	QUAD G047
	T9	thu	10:00 - 13:00	30	WEBSTER250
	t10	thu	13:00 - 16:00	60	WEBSTER251

ACCT 3708/ACCT3718 AUDITING AND ASSURANCE SERVICES
Provisional Workshop Schedule

Week	Week Beginning		Topic
1	July	26	Lecture - Introduction to Audit Function, Assurance Framework, Professional Standards and Structure of the Profession.
2	August	2	Workshop 1 - Introduction to the Audit Process, Risk and Audit Planning.
3	August	9	Workshop 2 - Control Risk Evaluation and Tests of Controls.
4	August	16	Workshop 3 - Evaluation of Detection Risk and Substantive Testing.
5	August	23	Workshop 4 - Analytical Procedures. Class Quiz
6	August	30	Workshop 5 – Auditors Response to Risks and Assessment of Materiality. Assignment Stage One Due.
7	September	6	Workshop 6 - Auditing in a CIS Environment — Internal Control.
8	September	13	MID-SESSION EXAM –Friday 17 September
9	September	20	Workshop 7 - Auditing in a CIS Environment — Substantive Testing.
	September	27	RECESS
10	October	4*	Workshop 8 - Using the Work of Others/Internal Audit/Public Sector Auditing
11	October	11	Workshop 9 - Completing the Audit Process and Audit Reporting. Assignment Stage Two Due.
12	October	18	Workshop 10 – Video – Revision
13	October	25	Workshop 11 - Legal Liability/Ethics.
14	November	1	Workshop 12 – Course Review and Current Issues

***Note: Monday 4 October is a Public Holiday**

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**

LECTURE: Week beginning 26 July 2004

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 1, Chapter 2 and Chapter 14

Standards:

AUS 106:	Explanatory Framework for Standards on Audit and Audit Related Services.
AUS 202:	Objective and General Principles Governing an Audit of a Financial Report.
AUS 206:	Quality Control for Audit Work.
AUS 210:	Fraud and Errors.
AUS 215:	Consideration of Laws and Regulations in an Audit of a Financial Report

HOMEWORK QUESTIONS:

1. What is the objective of an independent audit?
2. What is the concept of “assurance” in an audit setting?
3. Distinguish between management’s and the auditor’s responsibility for the financial reports being audited.
4. Explain the meaning of “true and fair” and “fairly presented” in the audit report.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT3708 AUDITING AND ASSURANCE SERVICES

Introduction to the Audit Process, Risk and Audit Planning

WORKSHOP 1: Week beginning 2 August 2004

NOTE: Groups will be formed during this workshop. Ensure you and your group members complete group assignment allocation forms for each group member – Refer page 67 of course outline.

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 5 (pages 175-182, 190-213)

Gay and Simnett, Chapter 6 (pages 226-253)

Standards:

AUS 302: Planning.
AUS 304: Knowledge of the Business.
AUS 306: Materiality.
AUS 402: Risk Assessments and Internal Controls.

A REVISION QUESTIONS

MaxMark Topics 1, 2 and 14

B PREPARATION QUESTIONS

1. Roebuck & Martinov Case 1.3 Parts 1 – 3 Pages 13-15. Solution Page 206-208.
2. Roebuck & Martinov Mock Exam No. 1 Question 1 Part (i) pg 163 and Solution pg. 169.

C HOMEWORK QUESTIONS

1. Roebuck & Martinov
Chapter 10, Question 5, Page 194.
2. Roebuck & Martinov
Chapter 10, Question 6, Page 194.

D CLASS GROUP DISCUSSION QUESTIONS

1. Roebuck & Martinov Case 1.5 Part 1, Pages 19 –20.

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Control Risk Evaluation and Tests of Controls

WORKSHOP 2: Week beginning 9 August 2004

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 8 (pages 321-349)

Gay and Simnett, Chapter 9 (pages 383-390)

Standards:

AUS 402 Risk Assessments and Internal Controls.

AGS 1006: Expression of an Opinion on Internal Control.

A REVISION QUESTIONS

MaxMark Topics 5 and 6

B PREPARATION QUESTIONS

1. Roebuck & Martinov Case 2.6 Parts 1 and 2 page 32 –34. Solution pages 209-210.
2. Roebuck & Martinov Mock Exam No. 1 Question 3 page 165. Solution Page 170.

C HOMEWORK QUESTIONS

1. 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.

2. Roebuck & Martinov Mock Exam No 2 Question 2 page 174.

D CLASS GROUP DISCUSSION QUESTIONS

1. Session 1, 2002, Exam Question 2

Modern Ltd is a large manufacturing organisation which through seasonal trends occasionally has surplus funds available for investment in marketable securities. The following represents a brief description of its procedures in dealing with securities transactions.

Investments in marketable securities are acquired through banks and brokers. The company does not have any regular broker through which security dealings are normally negotiated.

The board has recently delegated general authority to the treasurer (a non-board member) for the dealings in all securities of a short term nature. All securities purchased are held in the treasurer's safe to which only the treasurer and the treasurer's secretary have access (note either person can access the safe without the knowledge of the other party).

The treasurer initiates all purchases and disposals by telephone. Payments are made by the treasurer submitting a cheque request to the disbursements clerk to initiate a manual cheque rather than putting a sensitive transaction through normal mechanical cheque producing facilities. A copy of the brokers' advice is given to the accounting clerk in order to record the transaction. This advice is usually delivered by the secretary who also collects and mails the cheque to the broker. The treasurer keeps no subsidiary records of security dealings, however a report is given yearly to the board for their approval.

Required:

- 2 a) Identify five (5) internal control weaknesses for Modern Ltd.
- 2 b) Discuss the potential overall impact of the identified weaknesses on the Financial Statements of Modern Ltd.
- c) Discuss the role and responsibility of each of the following groups in relation to the internal control system of Modern Ltd:
 - 3 (i) Management
 - (ii) Audit Committee (assuming that one exists)

(iii) External Auditor

2. **Session 2, 2002, Exam Question 2**

Everyday Supplies Pty Ltd is a single-store retailer that sells a variety of tools, garden supplies, timber, small appliances, and electrical fixtures to the public, although about half of Everyday Supplies' sales are to construction contractors on account.

Retail customers pay for merchandise by cash or credit card at cash registers when merchandise is purchased. A contractor may purchase merchandise on account, if approved by the credit manager. This approval is based only on the manager's familiarity with the contractor's reputation. After credit is approved, the sales assistant files a pre-numbered order form with the accounts receivable supervisor to set up the receivable.

The accounts receivable supervisor independently verifies the pricing and other details on the order form by reference to a management-authorised price list, corrects any errors, prepares the invoice, and supervises a part-time employee who mails the invoice to the contractor. The accounts receivable supervisor electronically posts the details of the invoice in the accounts receivable subsidiary ledger and at the end of the day the total is automatically posted to the general ledger. The accounts receivable supervisor also prepares a monthly computer-generated accounts receivable subsidiary ledger and a monthly report of overdue accounts. Because of the automatic posting the accounts receivable subsidiary ledger is not reconciled with the accounts receivable control account in the general ledger.

The cash receipts functions are performed by the cashier, who also supervises the cash register clerks. The cashier opens the mail, compares each cheque with the enclosed remittance advice, stamps each cheque "for deposit only", and lists cheques for deposit. The cashier then gives the remittance advices to the bookkeeper for recording. The cashier prepares two deposit slips, one for cheques received each day and one for daily cash register receipts. These are banked at the end of each day. The cashier retains the verified deposit slips to assist in reconciling the monthly bank statements, but forwards to the bookkeeper a copy of the daily cash register summary. The cashier does not have access to the journals or ledgers.

The bookkeeper receives the details of transactions from the accounts receivable supervisor and the cashier for journalising and posting to the general ledger. After recording the remittance advices received from the cashier, the bookkeeper electronically transmits the remittance information to the accounts receivable supervisor for subsidiary ledger updating. The bookkeeper sends monthly statements to contractors with unpaid balances upon receipt of the monthly report of overdue balances from the accounts receivable supervisor. The bookkeeper authorises the accounts receivable supervisor to write off accounts as uncollectible when six months have passed since the initial overdue notice was sent. At this time, the credit manager is notified by the bookkeeper not to grant additional credit to that contractor.

Required:

- 7.5** **a) Describe five internal control weaknesses in Everyday Supplies' internal control structure for the cash receipts and billing functions. Explain briefly why each is a weakness.**

NOTE: Provide your answer in the following format:

Internal Control Weakness	Explanation of Weakness

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Evaluation of Detection Risk and Substantive Testing

WORKSHOP 3: Week beginning 16 August 2004

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 5 (pages 182-190)

Standards:

AUS 502: Audit Evidence.

A REVISION QUESTIONS

MaxMark Topics 8 and 9

B PREPARATION QUESTIONS

1. Roebuck & Martinov Mock Exam No 1 Question 1 page 163-4 and solution p169.
2. Roebuck & Martinov Case 9.3 Page 186 and Solution page 241-2.

C HOMEWORK QUESTIONS

1. Roebuck & Martinov Mock Exam No 2, Question 4 Page 177-8.
2. 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) identify 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.

3. Roebuck & Martinov Case 9.4 Part A, page 187

D CLASS GROUP DISCUSSION QUESTIONS

1. Session 1, 2002 Exam Question 1 (20 Marks)

Your audit client ABC Limited (ABC) a listed company, has presented you with the following information:

	Unaudited (projected)	Audited	Industry
	2002	2001	2001
Liquidity ratio	0.84	0.69	1.02
Gearing ratio	0.70	0.48	0.60
No. of times interest earned	3.02	5.02	4.0
Earnings per share	85.42¢	54.29¢	63.25¢
Return on equity	0.38	0.28	0.35
Net tangible assets per share	\$5.40	\$4.80	\$4.20
Share price	\$7.82	\$9.50	\$9.50
Inventory turnover	4.8	5.0	6.0

Additional information:

- ABC is in an industry which manufactures and distributes stationery. It is a mature industry with traditional customer loyalty being eroded by the introduction of large warehouse style outlets.
- Demand for the product is "flat" within Australia. There is a trend towards discounted brands by customers. As a result ABC has embarked on an intensive advertising campaign.
- ABC has been attempting to move vigorously into the Asia/Pacific region due to the intense competition locally.
- As a result of the Prices Surveillance Authority, a recent press release stated that ABC's products would remain subject to price controls. Plans to build a new factory have been scrapped.

- A potential takeover by a US company was announced in the last three (3) months.

Required:

- a) Based on the preliminary analytical procedures and the additional information provided:
- 4 (i) Identify and describe four (4) risks which you would consider in planning the audit for the 2002 year end;
 - 4 (ii) For each of the risks identified in (i), indicate which account is most at risk;
 - 4 (iii) For the account identified in (ii), identify the relevant financial report assertion most affected;
 - 4 (iv) Outline a specific substantive audit procedure to address the account and assertion at risk identified in (ii) and (iii) above.
- b) Your audit plan for sales for ABC places substantial reliance on the system of internal control and the use of analytical procedures. Your tests of control on the internal control system for sales has found a significant number of instances where customer's credit ratings have not been checked and abnormally large discounts have been given. The sales manager states that these changes have been the result of difficulties in maintaining past sales levels.
- 2 (i) Identify the prime account other than sales, and the financial report assertion at risk in the above situation.
 - 2 (ii) Considering that your control risk has now increased for the risky account and assertion identified in (i) above, and assuming inherent risk to be high, outline an audit strategy in terms of Tests of Control/Analytical Procedures/ Substantive Tests of Detail.

THE UNIVERSITY OF NEW SOUTH WALES
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Analytical Procedures

WORKSHOP 4: Week beginning 23 August 2004

CLASS QUIZ TO BE HELD IN THIS WORKSHOP

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 6 (pages 254-265)

Standards:

AUS 512 Analytical Procedures.

A REVISION QUESTIONS

MaxMark Topic 5

B PREPARATION QUESTIONS

1. Roebuck & Martinov Case 4.1 parts 1 & 2 page 58-59 and solution page 217-218.

C HOMEWORK QUESTIONS

1. **Session 2, 2002, Exam Question 1 (12 Marks)**

You are the audit senior on the audit of EasyFit Pty Ltd, a large manufacturer of shoes. EasyFit Pty Ltd's main market lies with 18 to 24 year olds.

This is the first year in which your firm has performed the audit (2002). As part of the planning work, you have performed analytical procedures on an annualised basis and compared the results to industry averages and last year's (2001) audited financial information. The results are given below:

	Ratio	Industry average		EasyFit Pty Limited	
		2002	2001	2002	2001
1	Current ratio	2.84	3.27	1.89	2.24
2	Receivables turnover ratio	4.9	4.6	6.3	7.0
3	Inventory turnover ratio	3.7	3.8	5.0	5.5
4	Return on total assets	7%	5%	13%	11%
5	Net profit ratio	0.06	0.06	0.04	0.04
6	Gross margin	0.20	0.26	0.20	0.18

Required:

- 6 a) Discuss the conclusions that the auditor can draw from the above ratios about EasyFit's financial position and performance.
- 6 b) Identify potential audit risks the auditor would need to investigate.

NOTE: Provide your answer in the following format:

a) Conclusion drawn	b) Potential risks indicated by ratio to further investigate

2. Roebuck & Martinov, Chapter 10, Question 35, Page 199

D CLASS GROUP DISCUSSION QUESTIONS

1. Session 1 1998 Question 3 Part B (6 MARKS)

WGRS Ltd manufactures electrical components. In the economy, inflation is coinciding with a recession, and interest rates for WGRS have increased from 8% at the beginning of the year to 14% at the end of the year. There has also been an increase in overseas competition due to recent government tariff reductions. The company has tried to boost sales by relaxing its credit policy.

Consider the following extracts from the financial statements of WGRS Ltd

	(\$'000s) 1998	(\$'000s) 1997	% change
Sales	2,000	1,700	+18%
Cost of goods sold	1,050	1,000	+5%
Gross margin	47.5	41.2	+15%
Interest expense	132	128	+3%
Long term liabilities	1,600	1,600	–
Interest rate (at 30 June)	14%	8%	n/a
Inventory	500	250	+100%
Accounts receivable	670	480	+40%
Provision for doubtful debts	14	10	+40%
Current ratio	1.94	2.39	-19%
Quick ratio	1.23	1.78	-31%
Inventory turnover (times per year)	2.1 times	4 times	-48%
Debtors turnover (times per year)	3.05	3.62	-16%

REQUIRED:

Identify the concerns (if any) you have with the following accounts or ratios, and their implications for the audit.

- (a) Interest Expense/Long-term Liabilities
- (b) Accounts Receivable/Provision for Doubtful Debts
- (c) Current Ratio/Quick Ratio and associated balances.

2. Session 1 2003 Question 2 (10 MARKS)

Question 2 (10 marks)

Your audit senior has provided you, the audit partner, with a memo on the results of the preliminary analytical procedures analysis for your client. The highlights are as follows:

- (a) Inventory turnover increased from 2.5 times to 3.75 times.
- (b) Depreciation expense has been about 2% of total assets for several years. This year it was only 1% of total assets.
- (c) Interest expense has been about 6% of total debt; this year it was 8%.
- (d) The quick ratio has decreased from 1.45 to 0.95.
- (e) Average days payable decreased from 35 days to 29 days.
- (f) Average days receivable increased from 28 days to 35 days.
- (g) Price/earnings has decreased from 10 times to 8 times.
- (h) Return on assets increased from 2.5% to 4%.

Required:

- 8 a) Assuming that each of these is considered material to the audit risk assessment, provide two (2) reasons that explain each change in the client's ratios: one that suggests a normal consequence of business and one that would suggest increased audit risk.

Present your answer in the following format:

Normal business explanation	Audit risk explanation

- 2 b) Indicate which of the increased audit risk scenarios noted in part (a) suggest the valuation assertion is at risk.

3. **Session 2 2003 Question 1 (10 MARKS)**

Comparative Ratio Analysis of XYZ Limited			
	Unaudited (projected) 2003	Audited 2002	Industry 2002
Current Ratio	2.13	1.74	2.14
Liquid or Quick Asset Ratio	0.69	0.84	1.02
Gearing/Debt Ratio	0.70	0.48	0.60
Earnings per Share	85.42¢	54.29¢	63.25¢
Return on Equity	0.38	0.28	0.35
Net Assets per Share	\$8.50	\$9.00	\$6.50
Share Price	\$4.70	\$9.50	\$9.50

Additional information:

- XYZ Limited (XYZ) is in an industry which manufactures and distributes gaming equipment (poker machines, roulette tables, etc.).
- XYZ has established markets in Australia and has recently (within the 2003 year) been attempting to move vigorously into the Asia/Pacific region.
- In the past Research and Development costs have not been written off in a manner consistent with that recommended by the applicable Accounting Standards. The effect has been immaterial and consequently the company has not received an audit qualification. For 2003 a considerable amount of research has been undertaken on new games.
- A potential takeover by a US company was announced in the last three (3) months.
- The company's Board has been subject to conflict and disagreement between various directors resulting in the recent resignation of the Chief

Executive Officer and the Chief Financial Officer over a revaluation of Trade Marks and Patents.

- The company has certain debt covenants based on return on equity being greater than 35%. This is also combined with a 'trigger' for repayment when share price falls below \$4.00.

Required:

- 3** a) i) Based on the preliminary analytical procedures and the other information provided, identify and describe three (3) key risks that the auditor of XYZ needs to consider in planning the 2003 audit.
- 4.5** ii) From your description of each of the risks in i), identify the key account affected by the risk and the prime financial report assertion for which evidence should be gathered.

NOTE: Present your answer to part a) in the following format:

Description of Risk	Account	Assertion
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- b) You have determined that the departure from the accounting standard ASRB 1011 "Accounting for Research and Development Costs" for 2003 will be material.
- 1** i) Outline the type of audit report you would issue and the basis of your decision.
- 1.5** ii) As part of your subsequent events review, you become aware that the share price has in fact fallen below \$4.00 and the loans XYZ Ltd has outstanding have been recalled. Discuss briefly the potential impact of this information on your audit report.

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ACCT 3708 AUDITING AND ASSURANCE SERVICES

Auditors Response to Risks and Assessment of Materiality

WORKSHOP 5: Week beginning 30 August 2004

NOTE: STAGE ONE OF ASSIGNMENT DUE

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 7

Standards:

AUS 306: Materiality.

AUS 402: Risk Assessments and Internal Controls.

AUS 406: The Auditor's procedures in response to Assessed Risk (operative from 15 December 2004)

AASB1031: Materiality.

A REVISION QUESTIONS

MaxMark Topic 6.

B PREPARATION QUESTIONS

1. None.

C HOMEWORK QUESTIONS

1. Roebuck & Martinov Mock Exam No. 2 Question 3 Parts A, B and C. Page 175.

D CLASS GROUP DISCUSSION QUESTIONS

1. **Session 1, 2003 Exam Question 1 (10 marks)**

Question 1 (10 marks)

During the planning stage of your current audit of Micro Ltd, a small computer manufacturer, you determine that due to declining sales volumes in the face of increased competition Micro has been unable to maintain minimum cash balances as required by a major loan agreement. Moreover, a significant

fourth quarter loss appears likely, leading to an overall loss for the year. This will be the first time Micro Ltd has sustained a loss in its five-year history. Further investigation of the computer industry reveals that several small manufacturers have failed during the past five years. The management of Micro Ltd has assured you that they are prepared to compete actively with the increased competition. Further, as a means of dealing with its severe liquidity problems, the management has decided to issue additional share capital.

Required:

- 5 a) Based on the above information, list five (5) specific factors that would affect your assessment of risk.**

Note: refer to suggested answer format presented below.

- 2.5 b) For each factor noted in (a) identify which component of the audit risk model it affects.**

- 2.5 c) For each factor noted in (a) describe the impact on the audit plan.**

Present your answer in the following format:

Risk Factor	Audit/Risk Model Component	Impact on Audit Plan

2. Session 2, 1999 Exam Question 1 (16 Marks)

You are the auditor of a medium sized fashion textile manufacturer, ABC Limited (ABC), that at the beginning of the year was listed on the Australian Stock Exchange. The major reason for the listing was to fund a significant expansion into the Japanese fashion market. Due to an economic recession and first time costs associated with the expansion, it appears that the company will be struggling to meet the forecast contained in the prospectus prepared as part of the listing requirements. Exchange rates against the YEN are steady, however the government has announced a cut in tariffs which is expected to have an adverse effect on demand for locally produced textiles. Already, a number of customers have asked that orders be held.

Your preliminary analytical procedures reveal the following:

	1998	1999
Current ratio	1.9	2.1
Liquid ratio	0.8	0.5
Days debtors outstanding	40	54
Inventory turnover	63 days	110 days
Share price	\$ 5.00	\$ 3.50
Net asset backing	\$ 5.00	\$ 5.00

Your review of the control environment suggests that key controls such as, authorisation and attitude of management, are satisfactory.

Your detailed review of the sales/accounts receivable system shows that a copy of the prenumbered sales invoice accompanied by a dispatch notice is sent to the accounts receivable clerk, who updates the accounts receivable subsidiary ledger. The sequence of sales invoices is independently accounted for each month and the subsidiary ledger is reconciled to the general ledger. A listing of accounts receivable is produced monthly and reviewed by the accountant, and analytical procedures including variance from budget, are produced for each salesperson and reviewed by the sales manager. The company has no formal follow-up procedure for debtors who do not pay within the required 30 days.

The controls over the cash receipts are regarded as satisfactory. On receipt of payment from a debtor a listing of receipts plus any supporting documentation is forwarded to the accounts receivable clerk who posts the entries to the subsidiary ledger. An independent computer reconciliation of the amount posted to the subsidiary ledger is sent to the accountant who reconciles this to the daily receipts shown on the bank deposit slip.

REQUIRED:

(a) Identify and discuss three (3) issues of significance which are highlighted by the preliminary analytical procedures (i.e. the ratios). Determine their effect on your overall risk assessment. [3 marks]

(b) From the information provided identify six (6) significant factors, other than those discussed in (a) above, and their impact (i.e. increase or decrease) on the evaluation of inherent risk. [3 marks]

(c) In relation to the sales/accounts receivable system identify ALL the

- internal control strength(s)
- internal control weakness(es)

and relate each to the relevant financial report assertion. [3 marks]

(d) For the valuation assertion in relation to ABC's 'Accounts Receivable' evaluate (high/medium/low):

- Control Risk,
- Inherent Risk,
- Detection Risk.

Justify your evaluation with reference to the information provided. [3 marks]

(e) Devise an audit strategy (Tests of Control/Analytical Procedures/Substantive Tests of Detail) for the valuation assertion in relation to 'Accounts Receivable' based on the evaluation of Inherent and Control Risk performed in (d) above. Explain your decision. [2 marks]

(f) From an audit point of view, verifying the existence of accounts receivable is relatively easier than verifying the valuation of this asset (accounts receivable).

Outline specific substantive audit procedures that enable the auditor to obtain a reasonable assurance about:

- Valuation, and
- Existence

of accounts receivable. [2 marks]

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ACCT 3708 AUDITING AND ASSURANCE SERVICES

Auditing in a CIS Environment – Internal Control

WORKSHOP 6: Week beginning 6 September 2004

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 8 (pages 349-360)

Gay and Simnett Chapter 9 (pages 415-420)

Standards:

AUS 214: Auditing in a CIS Environment.

A REVISION QUESTIONS

MaxMark Topic 7

B PREPARATION QUESTIONS

1. Roebuck and Martinov Case 2.6 page 34 and solution page 209

C HOMEWORK QUESTIONS

1. 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 PC 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.

2. 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

D CLASS GROUP DISCUSSION QUESTIONS

1. Session 2, 1997 Exam Question 2

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.

2. Session 1, 2003 Exam Question 3 (16 Marks)

Question 3 (16 marks)

In reviewing the processes, procedures and internal controls of one of your audit clients, Superbikes Ltd, you notice the following practices in place. They have recently installed a new computer system that affects the accounts receivable, billing, and shipping records. Three computer operators have been employed, and each has been assigned to oversee one of the functions of accounts receivable, billing and shipping.

Each of these computer operators is assigned the responsibility of running the program for transaction processing, making program changes, and reconciling the computer log. In order to prevent any one operator from

having exclusive access to the computer disks and documentation, these three computer operators randomly rotate the custody over the computer disks and the system documentation and the control tasks every two weeks. Access controls to the computer room consists of magnetic cards and a digital code for each operator. Access to the computer room is not allowed to either the systems analyst nor the computer operations supervisor.

The documentation for the computer system consists of the following: record layouts, program listings, logs and error listings.

Once goods are shipped from one of its three warehouses, warehouse personnel forward shipping notices to the accounting department. The billing clerk receives the shipping notice and accounts for the manual sequence of the shipping notices. Any missing notices are investigated. The billing clerk also manually enters the price of the item, prepares daily totals (supported by adding machine tapes) of the units shipped and the amount of sales. The shipping notices and adding machine tapes are sent to the computer department for data entry.

The computer output generated consists of a two copy invoice and remittance advice and a daily sales register. The invoices and remittance advices are forwarded to the billing clerk who mails one copy of the invoice and remittance advice to the customer and files the other copy in an open invoice file which serves as an accounts receivable document. The daily sales register contains the total of units shipped and sales amounts. The computer operator compares the computer generated totals to the adding machine tapes.

Required:

- 10 a) Identify five (5) internal control weaknesses present in the system described above and make a specific recommendation for correcting each of the control weaknesses.**

Present your answer in the following format:

Control Weakness	Recommendation

- 2 b) Explain how the presence of a CIS environment impacts the auditors' assessment of control risk.**

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MID-SESSION EXAMINATION
WEEK 8 BEGINNING 13 September 2004

A Mid-Session Examination worth 25% will be held during this week, on Friday 17 September, time and location to be advised. The exam covers material up to and including Week 6 (Workshop 5). No workshops will be conducted this week.

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Auditing in a CIS Environment – Substantive Testing

WORKSHOP 7: Week beginning 20 September 2004

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 10 (page 477-481)

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.
- AGS 1056: Electronic Commerce: Effect on the Audit of a Financial Report.
- AGS 1060: Commuter Assisted Audit Techniques

A REVISION QUESTIONS

MaxMark Topic 8.

B PREPARATION QUESTIONS

1. Roebuck & Martinov Exam No. 1 Question 2 Page 164-5 and Solution Page 170.
2. Roebuck & Martinov Case 4.5 Page 63 – 4 and Solution page 220-2.

C HOMEWORK QUESTIONS

1. 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 direct 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?

D CLASS GROUP DISCUSSION QUESTIONS

1. Session 2, 2002 Exam Question 3 (10 Marks)

Your client Global Limited holds a large portfolio of investments in shares of other entities, approximately 80% of them being listed on the stock exchange. Approximately 800 parcels of shares are held.

The following data on each share parcel is maintained on the computer system:

Date purchased
Date sold
Investee name
Total number of shares held (by class)
Number of shares sold (by class)
Class of shares held
Investment cost
Year-end market value
Profit/loss on sale
Dividend income

The above data is maintained on the computer for a period of two years.

Required:

- 2 a) Apart from report writing, detail two (2) examples of how generalised audit software (GAS) could assist in the audit of these investments.**
- 2 b) Identify the key assertions the auditor will wish to gather evidence on for these investments.**
- 6 c) Describe three (3) reports at least one (1) of which is an exception report, you would have the GAS produce. Your answer should indicate the report name, the details included in the report and how the report will be used by the auditor, including which management assertions (e.g. existence) are targeted by the report.**

NOTE: Provide your answer in the following format:

Report Name and Content	Audit use of Report

2. **Session 2, 2003 Exam Question 2 (11 Marks)**

Question 2 (11 marks)

You have completed your review of ABC Limited's (ABC) internal controls over accounts receivable and intend to gain reliance from the controls operating within its information processing system. The company has a computerised accounts receivable system purchased 'off the shelf' from a supplier of industry specific software.

The master file includes the following details in relation to each customer's account:

- Customer account number
- Customer name and address
- Credit limit
- Number of transactions this month
- Current month's charges
- Current month's receipts
- Balance
- Aged balance over 30 days
- Aged balance over 60 days
- Aged balance over 90 days
- Total sales this year to date
- Total returns this year to date
- Total sales last year
- Total returns last year

Required:

- | | |
|---|---|
| 2 | a) i) Describe briefly the method you would use to test programmed application controls. |
| 4 | ii) Outline two (2) different specific and practical programmed application controls you would expect to operate in ABC's accounts receivable system. For each of the controls illustrate how you would test whether the control was operating effectively. |
| 4 | b) From your review of Inherent Risk (IR) relating to accounts receivable you determine IR for the valuation assertion to be high. There also appears to be little follow-up of outstanding balances, and the results of your tests of control of the computer system indicate that credit limits are over-ridden.

Develop an audit strategy in terms of the relative reliance (i.e. none, small, moderate or extensive) that can be placed on detailed substantive tests, analytical procedures and tests of control. Justify the strategy developed. |
| 4 | c) Outline two (2) exception reports which could be produced from the accounts receivable master file to help you verify the valuation assertion in relation to the risk identified in b) above. Discuss how each of these reports will be utilised in providing relevant evidence necessary to substantiate valuation of accounts receivable. |

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ACCT 3708 AUDITING AND ASSURANCE SERVICES

Using the Work of Others/Internal Audit/Public Sector Auditing

WORKSHOP 8: Week beginning 4 October 2004

NOTE: Monday, 4 October is a public holiday. You will be advised to attend an alternate class if your workshop falls on this day.

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 8 (pages 361-364)

Gay and Simnett, Chapter 15

Gay and Simnett, Chapter 16

Standards:

- AUS 102: Introductory Statement of Applicability of Auditing Standards and Statements of Auditing Practice to Auditing in the Public Sector. Paragraph 43-44.
- AUS 602: Using the Work of Another Auditor.
- AUS 604: Considering the Work of Internal Auditing.
- AUS 606: Using the Work of an Expert.
- ED 30: Audit Exposure Draft, Compliance Auditing.
- AUS 806: Performance Auditing.
- AUS 808: Planning Performance Audits.
- AUS 904: Engagements to Perform Agreed-upon Procedures

A REVISION QUESTIONS

MaxMark Topic 10.

B PREPARATION QUESTIONS

1. Roebuck & Martinov Case 4.1 Part 3 Pages 58-59. Solution page 218.
2. Roebuck & Martinov Case 4.9 pages 68-9. Solution pages 223-4.
3. Roebuck & Martinov Mock Exam No. 1 Question 4 Part A page 166. Solution page 171.

C HOMEWORK QUESTIONS

1. Roebuck & Martinov, Case 9.2 Part A, Page 184
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. Roebuck & Martinov Case 4.12 Pages 71-2.
4. 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.
5. 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.

What particular problems are associated with measuring performance?

D CLASS GROUP DISCUSSION QUESTIONS

1. **Session 1, 2003 Exam Question 4 Part A (3 Marks)**

Distinguish between economy, efficiency and effectiveness, and explain whether they are related to the various audits under the comprehensive audit approach employed in the public sector.

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Completing the Audit Process and Audit Reporting

WORKSHOP 9: Week beginning 11 October 2004

NOTE: ASSIGNMENT STAGE TWO DUE

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 12
Gay and Simnett, Chapter 13
Gay and Simnett, Chapter 14

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.

A REVISION QUESTIONS

MaxMark Topics 3 and 4

B PREPARATION QUESTIONS

1. Roebuck & Martinov Case 5.8 Pages 85-86 and solution page 226-7.
2. Roebuck & martinov Case 9.6 Page 189 and Solution page 243.

C HOMEWORK QUESTIONS

1. 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.**
2. Explain how this situation should be dealt with in the financial statements. Justify your decision:

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.

3. 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 of 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.

D CLASS GROUP DISCUSSION QUESTIONS

1. Session 2, 2001 Exam Question 4 Part C (8 Marks)

- 2 (i) Explain briefly what is meant by the 'going concern' concept and its significance to the audit.
- 3 (ii) Based on the information provided what would be the value of buildings (a) under the going concern basis, and (b) if the company was not a going concern.

	\$000
Buildings at cost	6,000
Accumulated depreciation	500
Current sales value (excl. land)	3,000
Cost of disposal	25

- 3 (iii) Detail three (3) factors that would assist you in determining the 'going concern' basis for a home unit property developer. (Justify the relevance of each of the factors chosen)

NOTE: You may wish to present your answer in the following format:

Factor	Relevance to going concern

- 2. Roebuck & Martinov Case 5.4 Parts (i), (ii), (iii), (vi), Pages 79-81.

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Workshop 10: Week beginning 18 October 2004

Video: “How to Steal \$500 Million”

READING GUIDE

No prescribed reading. You are encouraged to review the following online edition of Frontline “Bigger than Enron”. The web address for this resource is:
<http://www.pbs.org/wgbh/pages/frontline/shows/regulation/view/>

A CLASS DISCUSSION

1. This video will be used as the basis for discussion of the following questions:
 - a) What accounting treatment did Phar – Mor use to hide their losses?
 - b) Which audit assertions would have been at risk given this accounting treatment?
 - c) How did Phar-Mor cover up their gross overstatement of inventory?
 - d) How was the fraud uncovered in the end?
 - e) Do you think the auditor’s testing should have uncovered the fraud or do you agree with Coopers & Lybrand that auditors are “watchdogs not bloodhounds”?
 - f) Are there any new audit standards / pronouncements that could specifically address the Phar-Mor issues?
 - g) The accounting department took the unethical option to continually falsify records for Phar-Mor. What other options would have been available to those staff?

2. Session 2, 2003 Exam Question 3 Part A (9 marks)

During the semester several corporate collapses involving fraud were discussed.

9 PART A

- (i) Provide three (3) specific examples from these cases of how the companies manipulated their financial statements.

- (ii) For each of your examples noted for part (i) provide specific details of audit procedures the auditor may have used to detect the manipulation.
- (iii) For each of your examples noted for part (i) identify the key audit assertion the auditors' should have addressed in their audit procedures.

NOTE: Present your answer to PART A in the following format:

Description of Manipulation	Specific Procedure to Detect Manipulation	Assertion
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Legal Liability / Ethics

WORKSHOP 11: Week beginning 25 October 2004

READING GUIDE

Textbook Reference:

Gay and Simnett, Chapter 3 and Chapter 4

Other References

Standards:

Joint code of Professional Conduct, Sections A,B,C4,C5,D1,D2,F1,F3,F5,F6 and F7.

AUS 204 Terms of Audit Engagements.

AUS 206: Quality Control for Audit Work.

APS 4: Statement of Quality Control Standard.

APS 5: Quality Control Policies and Procedures General Guidelines.

AGS 1014: Privy Letter Requests

A REVISION QUESTIONS

MaxMark Topics 8, 15 and 16.

B PREPARATION QUESTIONS

1. Roebuck & Martinov Mock Exam No. 1 Question 4 part B page 166 and solution page 171.
2. Roebuck & Martinov Case 6.1 page 88 and Solution page 227-8.
3. Roebuck & Martinov Case 6.3 Part 2 & 3 page 90 and Solution pages 229-31.

C HOMEWORK QUESTIONS

1. Roebuck & Martinov Mock Exam No. 3 Question 3 Page 181.
2. Roebuck & Martinov Case 6.9 Page 96-7.

3. Many of the 'Big 4' 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).

D CLASS GROUP DISCUSSION QUESTIONS

1. Session 2, 2002 Exam Question 4 Part B (7 marks)

- b) Audit independence has been described as the cornerstone of the auditing profession.

2 i) Define actual and perceived independence

5 ii) Explain the importance of each of these components. Support your answer using references to recent events in the business world.

2. Session 1, 2003 Exam Question 4 Part B (5 marks)

Discuss the implications of CLERP 9 for the perceived and actual independence of auditors.

3. Session 2, 2003 Exam Question 3 Part B (4 marks)

4 PART B

As a result of the corporate collapses involving fraud there have been worldwide calls for changes to the regulation of the Accounting and Auditing Profession. Discuss the response of the Australian regulatory bodies to such calls. Your answer should provide specific examples of suggested or mandated initiatives.

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Course Review and Current Issues

WORKSHOP 12: Week beginning 1 November 2004

READING GUIDE

No prescribed readings.

A REVISION QUESTIONS

None set. Note all topics are covered in the final exam.

B PREPARATION QUESTIONS

None set. Note all topics are covered in the final exam.

C HOMEWORK QUESTIONS

None set.

D CLASS GROUP DISCUSSION QUESTIONS

Session 1, 2004 Final Exam

Question 1 (12 marks)

Plastics Limited is a medium size manufacturing company producing moulded plastic and rubber components. The company is well established and has a good profitability record. Most of its products are produced for major manufacturers of refrigerators.

The 'white goods' industry has undergone a considerable downturn recently with a number of local manufacturers closing down. This has been due to new environmental regulations, along with increased competition from New Zealand and parts of Asia. New designs in refrigeration have also been introduced requiring new processing techniques.

The Managing Director and majority of the Board have a very good knowledge of the industry and take a responsible attitude towards the running of the company.

The company has a large investment in its plant and equipment. The yearly capital expenditure budget (which is material) is the joint responsibility of the Director of Manufacturing and the Chief Accountant. The Director of Manufacturing has an input in terms of manufacturing needs and expertise, while the Chief Accountant has a detailed

knowledge of expected cash flows. The final capital expenditure budget is reviewed and approved by the Board. A detailed report of actual capital expenditure versus budget is submitted to the Audit Committee on a monthly basis and to the Board on a quarterly basis.

All new capital expenditure purchases are authorised by both the Director of Manufacturing and Chief Accountant. The additions are recorded in a fixed asset register by an accounting clerk. The company performs a yearly fixed asset stocktake and all differences are thoroughly investigated. The reconciliation prepared by the accounting clerk is reviewed by the Chief Accountant and the Audit Committee. The results of the asset stocktake are reported to the Board. The discrepancies found in the last four years have been only of a minor nature.

You have been the auditor of Plastics Limited for the last four years, and there have never been any significant errors discovered in your tests.

Required:

NOTE: Before answering, refer to suggested format below.

- (a) Provide an assessment of both inherent (IR) and control risk (CR) for plant and equipment. Justify your assessment by detailing four (4) factors in relation to IR and four (4) factors in relation to CR from the information provided.
- (b) Based on your assessment in (a) above, recommend the most appropriate audit strategy in terms of relative reliance (i.e. none, small, moderate or extensive) that can be placed on detailed substantive tests, analytical procedures or tests of control for the plant and equipment account balance. Justify the strategy developed.
- (c) Identify the two (2) key financial report assertions in relation to the plant and equipment account. For each of the assertions, outline one (1) specific substantive test of detail to obtain audit evidence.
- (d) Identify one (1) specific internal control on which you might wish to place reliance. Design one (1) appropriate test of control to substantiate the existence and effectiveness of the control.

Your answer should be presented in the following format:

a)

IR
Factors

Assessment

(i)

(ii)

(iii)

(iv)

CR

Assessment
Factors

(i)

(ii)

(iii)

(iv)

b) Audit Strategy

	Tests of Controls	Analytical Procedures	Detailed Testing	Substantive
Extent of testing (Extensive, small, moderate, none)				

Justification _____

c) Financial Report Assertions

(i) Assertion _____

Specific substantive test of detail _____

(ii) Assertion _____

Specific substantive test of detail _____

d) Internal Control _____

Test of Control _____

Question 2 (10 marks)

Part A (6 marks)

Analytical procedures provide a means of identifying unusual fluctuations caused by potential material errors or irregularities.

Using the format suggested below, for each of the following independent "unusual fluctuations" noted by the auditor describe:

- i) an intentional manipulation to improve the profit; and
- ii) a legitimate/acceptable reason for the fluctuation.

Required:

NOTE: Before answering, refer to suggested format below.

(a) Repairs and maintenance expense, as a percentage of production, has decreased from 15 to 5 percent during the current year.

(b) The number of employees has increased along with total payroll expense. However, the provision for long service leave account balance has reduced significantly.

(c) Sales for a retail store have increased by 20% during the year. However, merchant fees (charges paid by the retailer) have remained constant.

Suggested Format for Answer.

Situation	i) Intentional Manipulation	ii) Acceptable Reason
(a)		
(b)		
(c)		

Part B (4 Marks)

Your client Buckgreen Limited, is an importer of computer hardware and software. The company has been in the business for 10 years, during which time the business has grown significantly and successfully. However, you have identified obsolescence of inventory and poor profitability as specific industry risks, based on the constant technology change and strong competition.

You have calculated the following ratios as part of your preliminary analytical procedures:

	2004 (Unaudited)	2003 (Audited)
Current ratios	2.1	1.9
Quick ratio	1.5	1.2
Gross margin (%)	31.30	30.88
Earnings per Share (cents)	25.10	24.12
Average Return on Funds Employed (%)	57.9	53.2
Net Assets per Share (\$)	10.80	12.10
Share Price (latest available) (\$)	10.95	11.90

Required:

With reference to the above ratios, prepare preliminary conclusions as to the level of inherent risk in relation to the obsolescence of inventory and reduced profitability for Buckgreen Limited. Provide a justification for your assessment.

Your answer should be presented in the following format.

Industry risk	Level of Inherent Risk (low/medium/high)	Justification/ Explanation
Inventory Obsolescence		
Reduced Profitability		

Question 3 (8 marks)

You are the auditor of Loans Limited, and are in the process of planning the audit of their investment funds, which are strictly invested in residential mortgages. The year-end financial report includes the market value of the mortgage portfolio.

The mortgage subsidiary ledger is maintained on a centralised database in the following format:

Field	Information
1	Mortgage/loan number
2	Date of issue
3	Original mortgage/loan amount
4	Term of mortgage/loan
5	Amortisation period
6	Interest rate
7	Current balance outstanding
8	The market value of the mortgage/loan

You have satisfied yourself that general controls in the system are reliable.

Required:

NOTE: Your answer should be presented in the following format for parts (b) & (c).

Key Assertion	Explanation	GAS Examples
1.		1.
		2.
2.		1.
		2.

- a) Define general audit software (GAS).
- b) Identify two (2) key financial report assertions in relation to the mortgage/loan outstanding balance and explain why they constitute key assertions.
- c) For each assertion identified in b) above illustrate with at least two (2) specific examples how GAS can be used in the substantive testing of mortgage/loans outstanding.
- d) Detail one specific CIS control you would expect to find in the above system to assist with addressing the financial report assertion valuation.

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GROUP ASSIGNMENT

Note: This assignment will be completed in groups of four students as allocated in Week 3.

SESSION 2, 2004

ASSIGNMENT: (20%)

Due: Stage 1: Week 6 (Workshop 5), week commencing 30 August

Stage 2: Week 11 (Workshop 9), week commencing 11 October

Each stage to be collected at the commencement of the workshop

BACKGROUND

The new auditing “risk” standards become effective for all audits after 15 December 2004. The new standards replace the current standards as outlined below:

- Amendment to AUS 202/ISA 200 “Objective and Principles Governing and Audit of Financial Statements”
- AUS 402 “Understanding the entity and Its Environment and Assessing the Risks of Material Misstatement:

Replaces AUS 304 “Knowledge of the Business”; AUS 402 “Risk Assessments and Internal Control”; and AUS 214 “Auditing in a Computer Environment”

- AUS 406 “Auditor’s Procedures in Response to Assessed Risks”.

Replaces AUS 402 and 214 (see above).

- AUS 502 “Audit Evidence”

Replaces AUS 502 “Audit Evidence”.

One of the more significant changes included in the new standards relative to the existing AUSs is requiring the auditor to have an enhanced understanding of the entity, in particular:

- Obtain an enhanced understanding of the entity and its environment, including its business risks and internal control;
- Understand the entity’s risk assessment processes and management’s monitoring of controls; and
- Identify and link business risk to the risk of financial statement misstatement.

A commonly used tool to assist in conducting Strategic Business Risk Analysis, the **PEST** framework, decomposes the client's business environment into the following four spheres of influence (external forces):

Political
Economic
Social
Technological

PEST Factors to Consider	
Political and Legal	• Government stability and policy • Taxation policy • Government spending • Government relations with other countries • Industrial policy (e.g. towards privatisation, regulation, and nationalisation) • Employment law • Monopolies and mergers legislation • Environmental protection laws • Foreign trade regulations
Economic	• Inflation • Employment • Disposable income • Business cycles • Interest rates • GNP growth rates • Exchange rates • Energy and basic raw materials prices
Social and Cultural	• Population demographics • Income distribution • Levels of education • Lifestyle changes • Attitudes to work and leisure • Consumerism • Social mobility
Technological	• New discoveries/developments in our own or related (e.g. supplier) industry • Speed of technology transfer (diffusion) • Government spending on research • Rates of obsolescence

This Data is analysed to determine specific Business Risks for the particular entity and from these to determine specific Audit Risks (including account and assertion at risk). Once the Audit Risks are identified, the auditor then develops specific procedures to address each risk.

REQUIRED:

You are part of the audit team undertaking the audit of Woolworth Limited for the year ended 30 June 2004.

You are required to report on the following to your audit manager from currently available information:

Stage One: Due Week 6, commencing 30 August
(6 marks)

Provide a PEST analysis for Woolworths Limited

Length Limit: Maximum of 4 pages overall, with maximum of 1 page for each of the P.E.S.T. factors (size 12 font; 1½ spacing)

Note: Marks will be awarded based on depth of analysis.
Marks will be deducted for exceeding length limits.

Stage Two: Due Week 11, commencing 11 October
(14 marks)

a) Using the proforma PEST analysis* identify the core business risks facing Woolworths Limited. From this analysis, as well as your analytical procedures results, identify the audit risks faced by the auditor. Include in your answer the key account and assertion affected by each risk.
(8 marks)

* Note a standard proforma PEST analysis will be provided to you when stage one is returned.

b) Identify specific audit procedures to address each risk identified in part a).
(6 marks)

Format: Your answer should be presented in the following format:

Business Risk	Audit Risk	Key Account	Key Assertion	Specific Audit Procedure

Length Limit: Maximum of 8 pages overall, with maximum of 2 pages for each of the P.E.S.T. factors (size 12 font; 1½ spacing).

Note: Marks will be awarded based on depth of analysis and correct identification of audit risks and procedures.
Marks will be deducted for exceeding length limits.

ADDITIONAL MATERIAL

1. A Group Assignment Work Plan is included on page 65 to assist your completion of this assignment.
2. An Assignment Group Allocation Form is included on page 67 for you to keep a record of your group members.
You will be supplied with an additional form in week 2 (workshop 1) to complete and return to your workshop leader.

3. **A Group Assignment Peer Evaluation Form is included on page 69. Each group member is to complete and submit this form with the group assignment (in a sealed envelope if you wish to keep the information confidential).**

GROUP ASSIGNMENT WORK PLAN

By Week:-	Activity	Deliverable
3	Form groups of 4	Hand in completed 'Assignment Group Allocation Form' during Week 3 (Workshop 2)
6	Problem Scoping, Data Collection and Business Risk Assessment	Hand in Stage One of Assignment during Workshop. PEST analysis for Woolworths Limited
8	Analytical Procedures Audit Risk Analysis and Audit Procedures.	
11	Completion of Assignment	Hand in Stage Two of Assignment during Workshop, along with peer assessments.

Assignment Group Allocation Form

Workshop Details

Day and Time: _____

Number: _____

Lecturers: _____

Group Details:

Group Name:
(Optional) _____

**Group
Members:**

Student Names:

**Student
Numbers:**

1	_____	_____
2	_____	_____
3	_____	_____
4	_____	_____

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School of Accounting

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Session 2, 2004**

GROUP ASSIGNMENT PEER EVALUATION FORM

The purpose of this form is to allow you to assess the amount of effort each member of your group has put into the completion of the assignment

You should take care to complete this form honestly.

Individual responses will be kept confidential.

In the spaces provided, list all members of your group (including yourself) and allocate a mark out of 10 to each group member to indicate their effort in completing the assignment

Each group member's mark will be determined using the following formula:

Assume the assignment was awarded a mark of 6/10 and you were awarded a peer evaluation average of 8/10. This would result in you receiving a final mark of 4.8 out of 10, calculated as 80 percent of 6. If you were awarded a peer evaluation average of 10/10 you would receive the full 6 marks out of 10.

Please note that the marks are NOT allocated proportionally across the group members. In other words if all the group members receive a peer evaluation average of 10/10 then using the above example everyone will receive 6 out of 10.

Workshop Details:

Workshop Day and Time:.....

Tutor:.....

Group Details: Group Name (Optional):

Group Members:

Student Names:	Student Numbers:	Mark out of 10:
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1. Your Name and Student Number:

.....		
-------	-------	-------

Other Group Members:

2.		
---------	-------	-------

3.		
---------	-------	-------

4.		
---------	-------	-------

PLEASE HAND THIS FORM TO YOUR TUTOR DURING YOUR WORKSHOP IN WEEK 11

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PAST FINAL EXAM – MULTIPLE CHOICE ANSWERS

PAST FINAL EXAM - MULTIPLE CHOICE ANSWERS								
YEAR	2000	2001	2001	2002	2002	2003	2003	2004
SESSION	2	1	2	1	2	1	2	1
Question								
1	c	b	b	a	b	c	b	a
2	c	b	a	b	b	d	a	b
3	d	c	c	a	a	b	d	d
4	d	c	d	b	a	a	a	b
5	b	b	a	d	b	d	a	b
6	a	b	b	d	a	c	a	b
7	b	d	b	b	d	b	a	d
8	b	a	b	c	a	d	a	a
9	d	a	c	a	b	c	c	b
10	a	b	d	b	d	b	b	c
11			c	b	b	a	a	
12			b	b	a	a or c	a	
13			c	b	a	c	b	
14			a	a	a	b	a	
15			d	c	d	a	b	
16						d	c	

WebCT

WebCT (Web Course Tools) is a Web-based software application used at UNSW for online learning and teaching activities. When you log on to your *myWebCT* account you will see a list of all the courses you are registered in, which have WebCT components. If a course doesn't have a WebCT component then it won't be listed. Your lecturers will advise you how they are intending to use WebCT in their courses.

To view your WebCT courses you will need to have:

- a username and password
- a computer with internet access
- a Web browser installed with Java, JavaScript and cookies enabled in the browser settings, and with the cache set to display a new version of a page every time it is visited.

Internet Explorer is the preferred browser as it performs much more reliably than Netscape. Specific browser versions that work with WebCT are:

- Microsoft Internet Explorer version 5.0 or higher, including 6.0 (version 5.5 SP1 has a bug and is not supported, but 5.5 SP2 is supported)
- Netscape 4.76 and 6.2.1 (4.78, 4.79, 6.0 and 6.01 have bugs and are not supported).

Log on to the following site for a full student guide to using WebCT:

<http://www.accounting.unsw.edu.au/students/courses-websites.htm>