Answers

1 (a) Audit procedures procurement and purchases system

Procedure	Reason for procedure
Obtain a sample of e-mails from the store manager's computer. Trace details to the order database.	Ensure that all orders are recorded and that the order details are correct.
Obtain a sample of orders in the order database, record details of the order and trace to the paper delivery note filed in the goods inwards department.	To confirm that all goods ordered were received.
For the sample of orders above, agree to the inventory database.	To confirm that goods received were completely and accurately recorded in the inventory database.
Obtain a sample of paper delivery notes and agree to the order database and inventory database.	To confirm that inventory received has been recorded in DinZee's accounting system and that liabilities are therefore not understated.
For a sample of orders in the orders database, agree details to the payables ledger database, confirming details against the purchase invoice.	To confirm complete and accurate recording of the inventory liability in the payables database. Note: To ensure goods received have been recorded as a payables liability the sample selected from the order database should be only those orders that have been received. The invoice number in the order database is then noted and traced to the payables ledger in the purchase database.
Within the purchase database, obtain a sample of invoices recorded in the purchase day book, agree details of price and supplier to the purchase invoice record in the database.	To confirm that purchase invoice details have been correctly recorded in the payables database.
For a sample of purchase invoices in the purchase day book, agree details to the delivery notes for items on that invoice.	To confirm that the purchase liability has been recorded only for goods actually received.
For the sample of purchase invoices above, agree details to the individual payables account in the payables database.	To confirm that the liability has been recorded in the correct payables account.
For a sample of supplier invoices, cast and cross cast invoice price and quantities confirming price to the original order.	To confirm the arithmetical accuracy of invoices and ensure the company was charged the correct price for goods received.
Select increases in the purchase daybook and vouch to the order database.	To ensure that invoiced goods have been ordered, confirming the occurrence assertion.
Using computer-assisted audit techniques, cast the purchase day book and agree total of liability incurred to the general ledger.	To confirm the completeness and accuracy of the liability recorded in the general ledger.

(b) Audit procedures prior to inventory count attendance

Procedure
- Review prior year working papers
- Contact client to obtain stocktaking instructions
- Book audit staff to attend the inventory counts
- Obtain copy of inventory count instructions from client
- Ascertain whether any inventory is held by third parties
- Obtain last year's inventory count memo
- Prepare audit programme for the count.

(c) Weaknesses in counting inventory

Weakness	Reason for weakness	How to overcome weakness
Inventory sheets stated the quantity of items expected to be found in the store	Count teams will focus on finding that number of items making undercounting of inventory more likely – teams stop counting when 'correct' number of items found.	Count sheets should not state the quantity of items so as not to pre-judge how many units will be found.
Count staff were all drawn from the stores	Count staff are also responsible for the inventory. There could be a temptation to hide errors or missing inventory that they have removed from the store illegally.	Count teams should include staff who are not responsible for inventory to provide independence in the count.
Count teams allowed to decide which areas to count	There is a danger that teams will either omit inventory from the count or even count inventory twice due to lack of precise instructions on where to count.	Each team should be given a precise area of the store to count.
Count sheets were not signed by the staff carrying out the count	Lack of signature makes it difficult to raise queries regarding items counted because the actual staff carrying out the count are not known.	All count sheets should be signed to confirm who actually carried out the count of individual items.
Inventory not marked to indicate it has been counted	As above, there is a danger that inventory will be either omitted or included twice in the count.	Inventory should be marked in some way to show that it has been counted to avoid this error.
Recording information on the count sheets in pencil	Recording in pencil means that the count sheets could be amended after the count has taken place, not just during the count. The inventory balances will then be incorrectly recorded.	Count sheets should be completed in ink.
Count sheets for inventory not on the pre-numbered count sheets were only numbered when used	It is possible that the additional inventory sheets could be lost as there is no overall control of the sheets actually being used. Sheets may not be numbered by the teams, again giving rise to the possibility of loss.	All inventory sheets, including those for 'extra' inventory, should be pre-numbered.

(d) **(i)** The aim of a test of control is to check that an audit client's internal control systems are operating effectively.

The aim of a substantive procedure is to ensure that there are no material errors at the assertion level in the client's financial statements.

(ii) Regarding the inventory count:

Test of control
Observe the count teams to ensure that they are counting in accordance with the client's inventory count instructions.

Substantive procedure
Record the condition of items of inventory to ensure that the valuation of those items is correct on the final inventory summaries.

2 **(a)** Fundamental principles

Integrity. A public accountant should be honest and straightforward in performing professional services.

Objectivity. A public accountant should be fair and not allow personal bias, conflict of interest or influence of others to override objectivity.

Professional competence and due care. When performing professional services, a public accountant should show competence and duty of care by keeping up-to-date with developments in practice, legislation and techniques.

Confidentiality. A public accountant should respect the confidentiality of information acquired during the course of providing professional services and should not use or disclose such information without obtaining client permission.

Professional behaviour. A public accountant should act in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession.

(b) Audit work – going concern

- Review management's plans for future actions based on its going concern assessment.
- Gather additional sufficient and appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists regarding the going concern concept.
- Seek written representations from management regarding its plans for future action.
- Obtain information from company bankers regarding continuance of loan facilities.
- Review receivables ageing analysis to determine whether there is an increase in days – which may also indicate cash flow problems.

3 **(a)** Factors limiting independence of internal audit

Reporting system

The chief internal auditor reports to the finance director. This limits the effectiveness of the internal audit reports as the finance director will also be responsible for some of the financial systems that the internal auditor is reporting on. Similarly, the chief internal auditor may soften or limit criticism in reports to avoid confrontation with the finance director.

To ensure independence, the internal auditor should report to an audit committee.

Scope of work

The scope of work of internal audit is decided by the finance director in discussion with the chief internal auditor. This means that the finance director may try and influence the chief internal auditor regarding the areas that the internal audit department is auditing, possibly directing attention away from any contentious areas that the director does not want auditing.

To ensure independence, the scope of work of the internal audit department should be decided by the chief internal auditor, perhaps with the assistance of an audit committee.

Audit work

The chief internal auditor appears to be auditing the controls which were proposed by that department. This limits independence as the auditor is effectively auditing his own work, and may not therefore identify any mistakes.

To ensure independence, the chief internal auditor should not establish control systems in Matalas. However, where controls have already been established, another member of the internal audit should carry out the audit of petty cash to provide some limited independence.

Length of service of internal audit staff

All internal audit staff at Matalas have been employed for at least five years. This may limit their effectiveness as they will be very familiar with the systems being reviewed and therefore may not be sufficiently objective to identify errors in those systems.

To ensure independence, the existing staff should be rotated into different areas of internal audit work and the chief internal auditor independently review the work carried out.

Appointment of chief internal auditor

The chief internal auditor is appointed by the chief executive officer (CEO) of Matalas. Given that the CEO is responsible for the running of the company, it is possible that there will be bias in the appointment of the chief internal auditor; the CEO may appoint someone who he knows will not criticise his work or the company.

To ensure independence, the chief internal auditor should be appointed by an audit committee or at least the appointment agreed by the whole board.

(b) Internal control weaknesses – petty cash

Weakness	Suggested control
The petty cash balance is approximately three months expenditure. This is excessive and will increase the possibility of petty cash being stolen or errors not being identified.	The petty cash balance should be $2,000, being about one month's expenditure.
The petty cash box itself is not secure; it is placed on a bookcase where any member of staff could steal it.	When not in use, the petty cash box should be kept in the branch safe, or at least a locked drawer in the accountant's desk.
Petty cash appears to be used for some larger items of expenditure (up to $500). Vouchers are only authorised after expenditure is incurred indicating that some significant expenditure can take place without authorisation.	A maximum expenditure limit (e.g. $50) should be set before which prior authorisation is required.
Petty cash vouchers are only signed by the person incurring the expenditure, indicating a lack of authorisation control for that expenditure.	All vouchers should be signed by an independent official showing that the expenditure has been authorised.
Petty cash only appears to be counted by the accounts clerk, who is also responsible for the petty cash balance. There is no independent check that the petty cash balance is accurate.	The counting of petty cash should be checked by the accountant to ensure that the clerk is not stealing the cash.
When the imprest cheque is signed, only the journal entry for petty cash is reviewed, not the petty cash vouchers. The accountant has no evidence that the journal entry actually relates to the petty cash expenditure incurred.	The petty cash vouchers should be available for review to provide evidence of petty cash expenditure.
Petty cash vouchers are not pre-numbered so it is impossible to check the completeness of vouchers; unauthorised expenditure could be blamed on 'missing' vouchers.	Petty cash vouchers should be pre-numbered and the numbering checked in the petty cash book to confirm completeness of recording of expenditure.

4 (a) Audit procedures using audit software

Procedure	Reason for procedure
Cast the receivables ledger to ensure it agrees with the total on the receivables control account.	To ensure the completeness and accuracy of recording of items in the receivables ledger and control account.
Compare the balance on each receivable account with its credit limit to ensure this has not been exceeded.	To check for violation of system rules.
Review the balances in the receivables ledger to ensure no balance exceeds total sales to that customer.	To check for unreasonable items in the ledger.
Calculate receivables days for each month end to monitor control of receivables over the year.	To obtaining new/relevant statistical information.
Stratify receivables balances to show all material items and select appropriate sample for testing.	To select items for audit testing.
Produce an aged receivables analysis to assist with the identification of irrecoverable receivables.	To assist with receivables valuation testing.

(b) Problems of using audit software

Cost
There may be substantial setup costs to use the software, especially where the computer systems of the client have not been fully documented, as is the situation in Delphic Co. A cost benefit analysis from the audit point-of-view should be carried out prior to deciding to use audit software.

Lack of software documentation
The computer audit department at Delphic cannot confirm that all system documentation is available, especially for the older 'legacy' systems currently in use. This again confirms the view that use of audit software should be deferred until next year to avoid extensive setup costs which cannot be recouped due to system changes.

Change to clients' systems
Changes to clients' computer systems can result in costly amendments to the audit software. Given that Delphic's systems will change next year, this is almost certain to result in amendments to the software. Starting to use audit software this year is therefore not advisable.

Outputs obtained
The audit manager needs to be clear exactly what audit assertions are to be tested with the audit software and what outputs are expected. Starting testing just to obtain knowledge of the system is inappropriate as testing may be too detailed and output produced that is not required, increasing the cost for the client.

Use of copy files
The use of copy files means that the auditor will not be certain that these are the actual files being used within Delphic's computer systems, especially as the provenance of those files will not be checked. To ensure that the files are genuine either the auditor should supervise the copying or the 'live' files on Delphic's computer systems should be used.

(c) Auditing around the computer

This term means that the 'internal' software of the computer is not documented or audited by the auditor, but that the inputs to the computer are agreed to the expected outputs from the computer.

This method of auditing increases audit risk because:

– The actual computer files and programs are not tested; the auditor has no direct evidence that the programs are working as documented.
– Where errors are found in reconciling inputs to outputs, it may be difficult or even impossible to determine why those errors occurred. Constructive amendments to clients' systems cannot be made and there is an increased likelihood of audit qualifications.

5 **(a)** Audit procedures regarding non-depreciation of buildings

– Review audit file to ensure that sufficient appropriate audit evidence has been collected in respect of this matter.
– Ensure that Singapore Financial Reporting Standards does apply to the specific buildings owned by Galartha Co and that a departure from Singapore Financial Reporting Standards is not needed in order for the financial statements to show a true and fair view.
– Meet with the directors to confirm their reasons for not depreciating buildings.
– Warn the directors that in your opinion buildings should be depreciated and that failure to provide depreciation will result in a modified audit report.
– Determine the effect of the disagreement on the audit report in terms of the modified opinion being material or of pervasive materiality to the financial statements.
– Draft the appropriate sections of the modified audit report.
– Obtain a letter of representation from the directors confirming that depreciation will not be charged on buildings.

(b) Audit report extracts

Extract 1.

The meaning of the extract. It confirms that audit work has been carried out in accordance with external Auditing Standards – not arbitrary standards made up by the audit firm and that audit planning was carried out to detect material errors.

The purpose of the extract. It provides the readers of the financial statements with that the auditor can be trusted to carry out the audit because the auditor has followed the ISAs and the ethical standards of the ACCA.

Extract 2.

The meaning of the extract. It states that the auditor has compared the normal accounting treatment for depreciation (in the IAS) to that used by the directors and found the directors' method to be different to the standard.

The purpose of the extract. It informs readers that the company is not following the IAS in this particular matter and so the financial statements may be incorrect in this respect.

Extract 3.

The meaning of the extract. It shows how the IAS would normally be applied to non-current tangible assets – in this case a standard 5% depreciation rate has been used.

The purpose of the extract. Enables the reader of the financial statements to quantify the impact of the IAS non-compliance – in this case $420,000.

Extract 4.

The meaning of the extract. It shows the overall impact of non-compliance with the IAS – with specific focus on the overstatement on non-current assets of $1,200,000.

The purpose of the extract. It enables the reader to see the overall quantified impact on the financial statements – that is non-current assets and profit are both overstated. The members' perception of the 'value' of their company may therefore be altered.

Extract 5.

The meaning of the extract. That the auditor disagrees with the depreciation figure provided by the directors – the auditor's calculation of depreciation is materially different from this hence the auditor's disagreement with the financial statements figure. However, this is the only matter that the auditor disagrees about.

The purpose of the extract. To communicate to the members that that auditor does not believe that the financial statements show a true and fair view in respect of depreciation.

(c) Other reporting options

(i)
- The auditor would still disagree with the lack of depreciation on non-current assets so a modified opinion on the grounds of disagreement would be required.
- As the financial statements need significant amendment (profit becoming a large loss) then the auditor may conclude that the financial statements do not show a true and fair view and issue an adverse report (rather than an 'except for' report).

(ii)
- The auditors normally attend the inventory count to confirm the existence of inventory. As the count was not attended, the existence of inventory cannot be confirmed.
- The auditor will be uncertain regarding existence and consequently valuation of inventory. An 'except for' audit report will be issued noting that adjustments may be necessary to the inventory value.

Marks

1 (a) Audit procedures procurement and purchases system

1 for stating procedure and 1 for the reason for that procedure. Limit marks to 0·5 where the reason is not fully explained. Maximum 2 marks per point.

Procedure
- E-mails to order database
- Order database to delivery note
- Orders to inventory database
- Paper goods receipt notes to inventory database
- Orders database to payables ledger database
- Computerised purchase invoice details to record of purchase invoice
- Details of purchase invoice database to EDI purchase invoice received
- Purchase invoice record to payables database
- CAATs – cast PDB, trace to general ledger
- Walk through test
- Observing goods being received
- Other relevant procedures

Maximum marks 12

(b) Audit procedures prior to inventory count attendance

0·5 for each procedure

Procedures
- Review prior year working papers for problems
- Contact client to obtain stocktake instructions
- Book audit staff to attend the inventory counts
- Obtain copy of inventory count instructions from client
- Ascertain whether any inventory is held by third parties
- Obtain last year's inventory count memo
- Prepare audit programme for the count
- Obtain prior year management letter for evidence of stocktake problems
- Other relevant points

Maximum marks 2

(c) Weaknesses in counting inventory

1 for each weakness, up to 1·5 for explaining the reason for the weakness and up to 1·5 for stating how to overcome weakness. 4 max therefore per weakness.

Weaknesses
- Inventory sheets stating the quantity of items expected to be found in the store
- Count staff all drawn from the stores
- Count teams allowed to decide which areas to count
- Count sheets not signed by the staff carrying out the count
- Inventory not marked to indicate it has been counted
- Recording information on the count sheets in pencil
- Count sheets for inventory not on the pre-numbered count sheets where only numbered when used
- Other relevant points

Maximum marks 12

(d) 1 mark each for:

Test of control aim
Substantive procedure aim
Stating test of control relevant to inventory count
Stating substantive procedure relevant to inventory count

Maximum marks 4

Total marks 30

			Marks
2	**(a)**	1 mark for each principle. 0·5 for stating the principle and 0·5 for brief explanation	
		– Integrity – Objectivity – Professional competence and due care – Confidentiality – Professional behaviour	
		Maximum marks	5
	(b)	1 mark per action	
		– Review management plans – Review cash flow forecasts – Additional audit procedures – Written representations – Loans from bank – Receivables ageing – Other relevant points	
		Maximum marks	5
		Total marks	10
		Note to markers – allow 0·5 mark where candidate lists audit procedures such as review cash flow forecasts, review management accounts post year end, etc.	
3	**(a)**	2 marks for each independence factor. 1 for explaining the issue and 1 for mitigating that factor.	
		– Reporting system – Scope of work – Actual audit work – Length of service of internal audit staff – Appointment of chief internal auditor – External auditor assistance with internal audit? (additional to answer) – Other relevant points	
		Maximum marks	8
	(b)	2 marks for each control weakness. 1 for explaining the weakness and 1 for control over that weakness.	
		– Size of petty cash balance – Security of petty cash box – High value petty cash expenditure – individual items – Authorisation of petty cash expenditure – Counting of petty cash – No review of petty cash vouchers – signing of imprest cheque – Vouchers not pre-numbered – Other relevant points	
		Maximum marks	12
		Total marks	20

		Marks
4	**(a)** Up to 2 marks for each procedure and explanation. 1 for the procedure and 1 for the explanation. Limit procedure to 0·5 if cannot be sustained from Delphic's systems.	

- Cast receivables ledger
- Compare ledger balance to credit limit
- Review balances ensure not excessive
- Calculation of receivables days
- Stratification of balances/audit sample selection
- Verify items in ledger
- Aged receivables analysis
- Other valid tests

Maximum marks — 9

Note to markers – no distinction is made between test of control and substantive procedures for this question. Marks can be obtained from either type of test or other relevant uses of audit software e.g. sample selection.

(b) 2 marks for each point. 1 for explaining the problem and 1 for showing how it can be resolved. Tests ideally must be related to the scenario; allow half marks if not related.

- Cost
- Lack of software documentation
- Change in client's system next year
- Outputs obtained
- Use of copy files
- Old system
- File compatibility
- Other relevant points

Maximum marks — 8

(c) Explanation of auditing around computer = 1 mark

1 mark for max two problems	1
– Actual computer files not tested – Difficult to track errors – Other relevant points	
	2
Maximum marks	3
Total marks	20

Marks

5 **(a)** 1 mark each for:

- Review of audit file
- Ensure true and fair override not required
- Meet with directors
- Warn directors about qualification
- Effect on audit report (material or pervasive materiality)
- Draft report
- Letter of representation
- Assets may not need depreciation (see accounting standard)
- Discuss with audit committee
- Other relevant points

Maximum marks 6

(b) 1 mark per point

Para 1
Work in accordance with external standards
Work to identify material misstatements
May be other material misstatements

Para 2
Shows auditor disagrees with directors
Shows auditor view based on standards

Para 3
Quantifies effect of non-compliance
Shows what depreciation policy normally is

Para 4
Confirms quantification of effect on financial statements
So members can see total effect

Para 5
'Except for' = material qualification
Everything else OK in FS

Other relevant points

Maximum marks 10

(c) 1 mark per point

(i) Still disagree – modify report (+ reason)
Qualification = 'fundamental'

(ii) Uncertainty on one item only = modify report
Qualification = material 'except for adjustments that may be necessary'

Maximum marks 4

Total marks 20