

## **Section C**

### **Question 1**

**This scenario relates to four requirements.**

You are an audit supervisor of Ant & Co and are planning the final audit of Centipede Co, which is a listed company, for the year ended 31 December 20X6. The company purchases consumer packaged goods and sells these through its website and to wholesalers. This is a new client for your firm and your audit manager has already had a planning meeting with the finance director and has provided you with the following notes along with financial statement extracts.

#### **Client background and notes from planning meeting**

Rather than undertaking a full year-end inventory count, the company undertakes monthly perpetual inventory counts, covering one-twelfth of all lines monthly. As part of the interim audit which was completed earlier in the year, an audit assistant attended a perpetual inventory count in September and noted that there were a large number of exceptions where the inventory records were consistently higher than the physical inventory in the warehouse. When discussing these exceptions with the finance director, the assistant was informed that this had been a recurring issue all year. In addition, the audit assistant noted that there were some lines of inventory which, according to the records, were at least 90 days old.

Centipede Co has a head office where the audit team will be based to conduct the final audit fieldwork. However, there are four additional sites where some accounting records are maintained and these sites were not visited during the interim audit. The records for these sites are incorporated monthly through an interface to the general ledger. A fifth site was closed down in 20X5, however, the building was only sold in 20X6 at a loss of \$825,000.

One of Centipede Co's wholesale customers is alleging that the company has consistently failed to deliver goods in a saleable condition and on time, hence it has commenced legal action against Centipede Co for a loss of profits claim.

The directors have disclosed their remuneration details in the financial statements in line with International Financial Reporting Standards, which does not require a separate list of directors' names and payments. However, in the country in which Centipede Co is based, local legislation requires disclosure of the names of the directors and the amount of remuneration payable to each director.

**Financial statement extracts for the year ended 31 December:**

	<b>Draft 20X6 \$'000</b>	<b>Final 20X5 \$'000</b>
Revenue	25,230	21,180
Cost of sales	(15,840)	(14,015)
Gross profit	9,390	7,165
Operating expenses	(4,903)	(3,245)
Operating profit	4,487	3,920
Inventory	2,360	1,800
Trade receivables	1,590	1,250
Cash	-	480
Trade payables	3,500	2,800
Overdraft	580	-

**Requirements :**

**(a) Describe the matters which Ant & Co should have considered prior to accepting the audit of Centipede Co. (5 marks)**

**(b) Calculate SIX ratios, for BOTH years, which would assist you in planning the audit of Centipede Co. (6 marks)**

**(c) From a review of the background and planning meeting notes, and the ratios calculated, describe SEVEN audit risks and explain the auditor's response to each risk in planning the audit of Centipede Co. (14 marks)**

Paragraph ▾
Table ▾
B I U S X<sub>2</sub> X<sup>2</sup> I<sub>x</sub>

(b)

Ratio	20X6	20X5	

(c)

Audit risk	Auditor's response

The finance director of Centipede Co informed Ant & Co that one of the reasons they were appointed as auditors was because of their knowledge of the industry. Ant & Co audits a number of other consumer packaged goods companies, including Centipede Co's main rival. The finance director has enquired how Ant & Co will keep information obtained during the audit confidential.

**(d) Explain the safeguards which Ant & Co should implement to ensure that this conflict of interest is properly managed. (5 marks)**

**(30 marks)**

**Question 2**

**This scenario relates to three requirements.**

Caterpillar Co is a clothing retailer which operates 45 stores throughout the country. The company's year end is 31 March 20X7. Caterpillar Co has an internal audit department which has undertaken a number of internal control reviews specifically focusing on cash controls at stores during the year. The reviews have taken place in the largest 20 stores as this is where most issues arise. You are an audit supervisor of Woodlouse & Co and are reviewing the internal controls documentation in relation to the cash receipts system in preparation for the interim audit which will involve visiting a number of stores and the head office.

Each of Caterpillar Co's stores has on average three or four cash tills to take customer payments. All employees based at the store are able to use each till and individuals do not have their own log on codes, although employees tend to use the same till each day. Customers can pay using either cash or a credit card and for any transaction either the credit card payment slips or cash are placed in the till by the cashier. Where employees' friends or family members purchase clothes in store, the employee is able to

serve them at the till point.

At the end of each day, the tills are closed down with daily readings of sales taken from each till; these are reconciled to the total of the cash in the tills and the credit card payment slips and any discrepancies are noted. To save time, this reconciliation is done by the store's assistant manager in aggregate for all of the store tills together. Once this reconciliation has taken place, the cash is stored in the shop's small safe overnight and in the morning it is transferred to the bank via collection by a security company. If the store is low on change for cash payments, a junior sales clerk is sent by a till operator to the bank with money from the till and asked to change it into smaller denominations.

The daily sales readings from the tills along with the cash data and credit card payment data are transferred daily to head office through an interface with the sales and cash receipts records. A clerk oversees that this transfer has occurred for all stores. On a daily basis, he also agrees the cash transferred by the security company has been banked in full by agreeing the cash deposit slips to the bank statements, and that the credit card receipts have been received from the credit card company. On a monthly basis, the same clerk reconciles the bank statements to the cash book. The reconciliations are reviewed by the financial controller if there are any unreconciled amounts.

**Requirements :**

**(a) State TWO control objectives of Caterpillar Co's cash receipts system. (2 marks)**

**(b) Identify and explain THREE CONTROL STRENGTHS in Caterpillar Co's cash receipts system and describe a TEST OF CONTROL the auditor should perform to assess if each of these controls is operating effectively. (6 marks)**

Control Strength	Test of Control

**(c) Identify and explain SIX DEFICIENCIES in Caterpillar Co's cash receipts system and provide a**

recommendation to address each of these deficiencies.

(12 marks)

(20 marks)

Control Deficiency	Control Recommendation

### Question 3

This scenario relates to four requirements.

You are an audit manager of Snail & Co and you are in charge of two audits which are due to commence shortly. Insects4U Co is a registered charity which promotes insect conservation and has been an audit client for several years. Spider Spirals Co, also an existing audit client, manufactures stationery products and its draft total liabilities are \$8.1m. Both clients' financial year ended on 31 October 20X6. The following matters have been brought to your attention for each company.

#### Insects4U Co

##### Completeness of income

Insects4U Co is a not-for-profit organisation which generates income in a number of ways. It receives monthly donations from its many subscribers and these are paid by bank transfer to the charity. In addition, a large number of donations are sent through the post to the charity. Insects4U Co also sells tickets for their three charity events held annually. During the audit planning, completeness of income was flagged as a key risk.

#### Spider Spirals Co

##### Trade payables

The finance director of Spider Spirals Co has informed you that at the year end the purchase ledger was

kept open for one week longer than normal as a large bank transfer and cheque payment run was made on 3 November 20X6. Some purchase invoices were received in this week and were recorded in the 20X6 purchase ledger as well as the payment run made on 3 November.

### **Trade receivables**

Spider Spirals Co has a large number of small customers; the normal credit terms offered to them is 30 days. However, the finance director has informed you that the average trade receivables days have increased quite significantly this year from 34 days to 55 days. This is partly due to difficult trading conditions and also because for six months of the year the role of credit controller was vacant. The company has historically maintained on average an allowance for trade receivables of 1.5% of gross trade receivables.

### **Requirements :**

- (a) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the matter identified regarding Insects4U Co.**  
**(4 marks)**

Note: Assume that the charity adopts International Financial Reporting Standards.

- (b) In relation to Spider Spirals Co, describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the matters identified regarding:**

**(i) Trade payables; and** **(6 marks)**

**(ii) Trade receivables** **(5 marks)**

The finance director of Spider Spirals Co has informed you that he is not proposing to make an adjustment for the trade payables payment run made on 3 November, as the total payment of \$490,000 would only require a change to trade payables and the bank overdraft, both of which are current liabilities.

- (c) Discuss the issue and describe the impact on the auditor's report, if any, should this issue remain unresolved.** **(5 marks)**

**(20 marks)**