



香港專業會計員協會

THE HONG KONG ASSOCIATION OF ACCOUNTING TECHNICIANS

(Incorporated with Limited Liability)

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Accounting Technician Examinations

Pilot Examination Paper

Level II

Paper 8 Auditing

Questions Suggested Answers and Marking Scheme

The Suggested Answers given in this Booklet are purposely made to give more details for educational purpose.

Published by HKAAT
5/2001

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Accounting Technician Examinations

Pilot Examination Paper

Level II

Paper 8 Auditing

Time allowed – 3 hours

Section A – 20 Multiple Choice Questions (compulsory)

Section B – 6 Questions (attempt any 4)

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INSTRUCTED TO DO SO BY THE SUPERVISOR**

SECTION A (MULTIPLE CHOICE QUESTIONS) (20 marks)

Answer **ALL** questions in this section. Choose the best answer for each question.

Marks will not be deducted for incorrect answers. Each question carries 1 mark.

1. What is the objective of an audit of financial statements?
 - A To enable auditors to identify internal control weaknesses
 - B To enable auditors to express a true and correct view
 - C To enable auditors to identify internal control weaknesses and express a true and correct view
 - D To enable auditors to express an opinion on whether the financial statements are prepared in accordance with an identified financial reporting framework
2. Which of the following is NOT a reason for auditors to understand the business of their audit client?
 - A To assist auditors in assessing risks and identifying problems
 - B To assist auditors in planning and performing the audit effectively and efficiently
 - C To assist auditors in providing consulting services to other clients
 - D To assist auditors in providing better service to the client
3. Which of the following is NOT an element of audit risk?
 - A Inherent risk
 - B Interest rate risk
 - C Control risk
 - D Detection risk
4. An example of an observation procedure is to
 - A perform stock counting.
 - B attend a client's physical stocktaking.
 - C compare the account balance between the bank statement and cash book.
 - D inspect the licence of the client's motor vehicle.
5. Which of the following procedures is unlikely to be carried out before the balance sheet date?
 - A Search for unrecorded liabilities
 - B Confirmation of bank balances
 - C Review of internal control over expense payments
 - D Attend physical stocktaking

6. Which of the following statements is NOT correct about representation by management?
- A It can take the form of a representation letter from the management.
 - B It is a letter from the auditors outlining the auditors' understanding of management's representations, duly acknowledged and confirmed by the management.
 - C It can take the form of relevant minutes of meetings of the board of directors.
 - D An oral representation is better evidence than a written representation.
7. Findings by internal auditors should ideally be reported to the
- A financial controller.
 - B board of directors.
 - C audit committee.
 - D government.
8. When auditors conclude that the effect of the matter giving rise to disagreement is so material or pervasive that the financial statements are seriously misleading, they should issue
- A an adverse opinion.
 - B an unqualified opinion.
 - C an except for disagreement opinion.
 - D an unqualified opinion with explanatory paragraph.
9. In preparing the financial statements, which of the following is NOT the responsibility of directors?
- A Select suitable accounting policies
 - B State the reasons for any significant departure from applicable accounting standards
 - C Make estimates that are prudent and reasonable
 - D Assess the adequacy of description in the auditor's report
10. Which of the following statements correctly explains "risk of incorrect rejection"?
- A The risk that, although the sample result does not support the auditors' assessment of control risk, the actual compliance rate would support such an assessment.
 - B The risk that, although the sample result supports the conclusion that a recorded account balance or class of transactions is materially misstated, in fact it is not materially misstated.
 - C The risk that, although the sample result supports the auditors' assessment of control risk, the actual compliance rate would not support such an assessment.
 - D The risk that, although the sample result supports the conclusion that a recorded account balance or class of transactions is not materially misstated, in fact it is materially misstated.

11. Which of the following is NOT a purpose of analytical procedures?
- A As a compliance test (test of control).
 - B To assist the auditors in planning the nature, timing and extent of other audit procedures.
 - C As an overall review of the financial statements in the final review stage of an audit.
 - D As substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions.
12. Which of the following statements is correct?
- A The computer information systems environment would not affect the consideration of inherent risk and control risk through which the auditors arrive at their risk assessment.
 - B The computer information systems environment would not affect the procedures followed by auditors in obtaining a sufficient understanding of the accounting and internal control systems.
 - C The overall objective and scope of an audit would not change in a computer information systems environment.
 - D The computer information systems environment would not affect the auditors' design and performance of tests of control and substantive procedures appropriate to meet the audit objective.
13. Which of the following matters is NOT normally set out in an audit engagement letter?
- A Arrangements regarding the planning of an audit
 - B The basis on which fees are computed and any billing arrangements
 - C Expectation of receiving from management written confirmation concerning representations made in connection with the audit
 - D Audit adjustments
14. Control environment means _____ of directors and management regarding the internal control system and its importance in the entity.
- A overall attitude
 - B awareness
 - C actions
 - D all of the above
15. Which of the following is NOT an appropriate audit procedure in identifying any litigation and claims involving the audit client, which may have a material effect on the financial statements?
- A Examining legal expense accounts
 - B Reviewing board minutes and correspondence with the client's solicitors
 - C Sending bank confirmation
 - D Making appropriate enquiries of management

16. Which of the following is NOT a commonly used method in audit sampling?
- A Random selection
 - B Systematic selection
 - C Irrational selection
 - D Judgemental selection
17. Which of the following factors will NOT influence the auditor's judgement in the determination of sample size for substantive procedures?
- A Population value
 - B Stratification
 - C Number of samples selected for tests of controls
 - D Expected error
18. Auditors should date the auditors' report as of
- A the completion date of the audit.
 - B the date of receipt of the management representation letter.
 - C the date of client's annual general meeting.
 - D the date of client's board of directors meeting approving the accounts.
19. Which of the following is NOT a commonly used auditing techniques requiring the use of computers?
- A Audit test data
 - B Tautology
 - C Parallel simulation
 - D Integrated test facility
20. Which of the following audit procedures is a substantive test of payroll transaction?
- A Review the appropriateness of segregation of duties between personnel, timekeeping and payroll payments
 - B Perform analytical review on payroll expenses
 - C Observe security over payroll records
 - D Enquire about the procedures over the distribution of pay cheques

(Total 20 marks)

[END OF SECTION A]

SECTION B (ANSWER FOUR QUESTIONS ONLY) (80 marks)

Answer any **FOUR** questions in this section. Each question carries 20 marks

- 1.** When events or conditions have been identified which may cast significant doubt on the entity's ability to continue as a going concern, the auditors should:
- (i) review management's plans for future actions based on its going concern assessment
 - (ii) gather sufficient appropriate audit evidence to confirm or dispel whether or not a fundamental uncertainty exists through carrying out procedures considered necessary, including considering the effect of any plans of management and other mitigating factors, and
 - (iii) seek written representations from management regarding its plans for future action.

(SAS 130.8)

REQUIRED:

- (a) **What is the going concern assumption?**
(3 marks)
- (b) **State FIVE factors that may influence an auditor's judgement as to what is sufficient appropriate audit evidence.**
(5 marks)
- (c) **Recommend FIVE appropriate audit procedures to ascertain whether an entity that has going concern doubts may be able to improve the situation.**
(10 marks)
- (d) **What type of audit opinion will an auditor give when the going concern assumption is found to be inappropriate?**
(2 marks)

(Total 20 marks)

2. An auditor may apply different techniques to document information relating to accounting and internal control systems. Selection of a particular technique is a matter of the auditor's judgement. Common techniques, used alone or in combination, are narrative descriptions, questionnaires, checklists and flowcharts.

During an assessment of the effectiveness of a client's internal control systems, an auditor will consider whether the client has adequate separation of duties.

REQUIRED:

- (a) **Describe four characteristics of narrative descriptions for documenting a client's accounting system and related controls.**
(4 marks)
- (b) **Describe the features of an internal control flowchart in documenting a client's accounting system and related controls, and its advantages.**
(5 marks)
- (c) **Discuss separation of duties with an example in respect of each of the following:**
(i) **custody of assets from record keeping**
(ii) **authorisation of transactions from the custody of related assets.**
(6 marks)
- (d) **Discuss separation of duties within EDP in respect of each of the following:**
(i) **programmer and computer operator**
(ii) **programmer and librarian.**
(5 marks)

(Total 20 marks)

3. Crystal Ltd offers only one product with a standardised packing. All credit sales are initiated from faxed customer orders. Crystal Ltd also has a small office in which customers can make cash purchase.

Credit sales

A sales clerk prepares a set of sales orders based on customer order received. All sales orders are pre-numbered and have six copies. The sales clerk attaches the customer order to sales order copy No. 1, and the set of documents is passed to the billing department for the billing clerk to prepare a set of sales invoices with an original and two copies. All sales invoices possess the same number as the sales orders. When the shipping department confirms the shipment, the billing clerk will send the original of the sales invoice directly to the customer. One sales invoice copy will be sent to accounting department for posting, and the other sales invoice copy is filed in the billing department.

The sales clerk passes sales order No. 2 to the accounting department for account posting. Sales orders No. 3 to 6 are passed to the warehouse for goods despatching.

Warehouse

The storekeeper packs the required quantity of goods and keeps sales order No. 3 for updating his inventory record. The goods and sales order Nos. 4 to 6 are transferred to the shipping department for further processing.

Shipping

A shipping clerk prepares the bill of lading from the sales order. Sales order No. 4 is sent to the customer as their packing slip. Sales order No. 5 is retained in the shipping department for updating records. The shipping department confirms the shipment to the billing department by sending it sales order No. 6.

Cash sales office

The cash sales office only has one clerk, who is responsible for running the sales office and banking all cash receipts on the last day of each month. Instead of recording each cash sales transaction through the cash register, the clerk hits the cash register once every month and records the monthly sales as one single transaction in the cash register's till roll. The clerk then submits the monthly sales report, the cash register's till roll, and the bank's pay-in slip to the accounting department on the fifth working day of the following month.

The clerk counts the stocks in the cash sales office annually and reports his count to the accounting department.

REQUIRED:

Identify ten internal control weaknesses and make recommendations for improvement.

(20 marks)

4. The following audit procedures are commonly found in the audit of purchases and payments cycle:
- (a) Select a sample of transactions from the cash payments journal and vouch to supporting documents.
 - (b) Perform year-end purchase cut-off test.
 - (c) Review payments made subsequent to balance sheet date and unpaid invoices.
 - (d) Select a sample of goods received note and trace to entries in cash payments journal.
 - (e) Perform analytical procedures, such as review on the level of physical production volume.
 - (f) Select a sample of trade creditors balances and trace to the documentation supporting a transaction or the transactions which give rise to the balances.
 - (g) Scan the trial balance of creditors ledger for material debit balances.
 - (h) Scrutinise the purchase journal for large or unusual items.
 - (i) Sending confirmations to creditors.
 - (j) Select suppliers with zero balances for confirmation.

REQUIRED:

Give the objectives or purpose of performing each of the above audit procedures.

(20 marks)

5. I-Toys Limited is a Hong Kong incorporated company with \$50 million share capital, and is preparing its first set of financial statements. Mr Cash, the president of I-Toys Limited, approached Mr Greed, the sole proprietor of Greed Certified Public Accountants to discuss the audit engagement of I-Toys Limited.

Mr Cash required Mr Greed to complete the audit within one week so that I-Toys Limited could submit the audited financial statements to a bank as part of a loan application. Mr Cash agreed to pay Mr Greed a fixed fee plus a bonus if the bank granted the loan.

Mr Greed hired two accounting students on a part-time basis to conduct the audit. Mr Greed instructed them not to spend time reviewing the internal controls, but to focus on tying the account balances to the trial balance and to prepare a set of financial statements with notes to the accounts. After one week, Mr Greed reviewed the set of financial statements drafted by the part-time staff and an unqualified auditor's report was issued thereon.

REQUIRED:

- (a) **Indicate and explain the actions of Mr Greed resulting in a failure to comply with professional ethics.**

(11 marks)

- (b) **Indicate and explain the actions of Mr Greed resulting in a failure to comply with the auditing standards – audit approach.**

(9 marks)

(Total 20 marks)

6. An international financial services company is planning to invest in a Hong Kong limited liability certified public accounting firm and has recruited a solicitor firm to give legal advice on the following matters in respect of providing statutory audits:
- (i) duties of auditors
 - (ii) rights of auditors
 - (iii) reasonable standard of care
 - (iv) responsibility of auditor and director of an audit client.

REQUIRED:

- (a) **State the duties of an auditor under sections 141(1), 141(3) and 141(4) of the Companies Ordinance.**
(6 marks)
- (b) **State the rights of an auditor given under the Companies Ordinance that can empower the auditors to carry out their duties of reporting to the members on the financial statements.**
(4 marks)
- (c) **State the rights of an auditor upon resignation given under the Companies Ordinance.**
(4 marks)
- (d) **List four factors in determining what is a reasonable standard of care for an auditor.**
(4 marks)
- (e) **Distinguish the responsibility of auditors from that of the directors.**
(2 marks)

(Total 20 marks)

[END OF PILOT EXAMINATION PAPER]

Accounting Technician Examinations

Pilot Examination Paper

Level II

Paper 8 Auditing

Suggested Answers and Marking Scheme

SECTION A (MULTIPLE CHOICE QUESTIONS) (20 marks)

1. D
2. C
3. B
4. B
5. A
6. D
7. C
8. A
9. D
10. B
11. A
12. C
13. D
14. D
15. C
16. C
17. C
18. A
19. B
20. B

(Total 20 marks)

SECTION B (ANSWER FOUR QUESTIONS ONLY) (80 marks)

1. (a) The going concern assumption is a fundamental principle in the preparation of financial statements. [1 mark] Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future [1 mark] with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws and regulations. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. [1 mark]

(3 marks)

- (b) Factors affecting an auditor's judgement as to what is sufficient appropriate audit evidence:
- (i) Auditor's assessment of the nature and level of inherent risk at both the financial statements level and the account balance or class of transaction level.
 - (ii) Nature of the accounting and internal control systems and the assessment of control risk.
 - a. Materiality of the item being examined.
 - b. Experience gained during previous audits.
 - c. Results of audit procedures, including fraud or errors which may have been found.
 - d. Source and reliability of information available.

[Any five points, each 1 mark, maximum 5 marks]

(5 marks)

- (c) Audit procedures to ascertain whether an entity with going concern doubts may be able to improve the situation may include:
- i Analysing and discussing cash flow, profit and other relevant forecasts with management.
 - ii Analysing and discussing the entity's latest available interim financial statements.
 - iii Reviewing the terms of debentures and loan agreements and determining whether any have been breached.
 - iv Reading minutes of the meetings of shareholders, the board of directors and important committees for reference to financing difficulties.
 - v Enquiring of the entity's lawyer of the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.

- vi Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties, and assessing the financial ability of such parties to provide additional funds.
- vii Considering the entity's plans to deal with unfilled customer orders.
- viii Reviewing events after the period end to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.

[Any five points, 2 marks each, maximum 10 marks]

(10 marks)

- (d)** If an auditor concludes that the going concern assumption used in the preparation of the financial statements is inappropriate, then he will express an adverse opinion regardless of whether or not disclosure has been made.

The opinion is based on the additional procedures carried out and the information obtained, including the effect of management's plans, and the auditor's judgement.

(2 marks)

(Total 20 marks)

2. (a) A proper narrative of an accounting system and related controls includes four characteristics.
- (i) The origin of every document and record in the system. For example, the description should state where customer orders come from and how sales invoices arise. [1 mark]
 - (c) All processing that takes place. For example, if sales amounts are determined by a computer programme that multiplies quantities shipped by stored standard prices, the calculation method should be described. [1 mark]
 - (d) The disposition of every document and record in the system. The filing of documents, sending them to customers, or destroying them should be shown. [1 mark]
 - (e) An indication of the controls relevant to the assessment of control risk. These typically include separation of duties (such as separating recording cash from handling cash); authorisations and approvals (such as credit approvals); and internal verification (such as comparison of unit selling price with sales contracts). [1 mark]

(4 marks)

- (b) An internal control flowchart is a symbolic, diagrammatic representation of the client's documents and their sequential flow in the organisation. [1 mark]

The advantages of flowcharting are:

- (i) Provide a concise overview of the client's system, which is useful to the auditor as an analytical tool in evaluation. A well-prepared flowchart aids in identifying inadequacies by facilitating a clear understanding of how the system operates. [1 mark]
- (ii) It is superior in showing adequate separation of duties. [1 mark]
- (iii) It is easier to follow a diagram than to read a description. [1 mark]
- (iv) It is easier to update a flowchart than a narrative. [1 mark]

(5 marks)

- (c) (i) Separation of the custody of assets from record keeping

The reason for not permitting the person who has temporary or permanent custody of an asset from record keeping is to protect the firm against defalcation. [1 mark] When one person performs both functions, there is an excessive risk of that person's disposing of the asset for personal gain and adjusting the records to relieve himself or herself of responsibility. [1 mark]

For example, if the cashier receives cash and is responsible for data entry for cash receipts and sales, it is possible for the cashier to misappropriate the cash and adjust the customer's account by failing to record a sale, or by recording a fictitious credit to the account. [1 mark]

- (ii) Separation of the authorisation of transactions from the custody of related assets

If possible, it is preferable to prevent persons who authorise transactions from having control over the related asset. [1 mark] The authorisation of a transaction and the handling of the related asset by the same person increase the possibility of defalcation within the organisation. [1 mark]

For example, the same person should not authorise the payment of a vendor's invoice and also sign the cheque in payment of the bill. [1 mark]

(6 marks)

- (d) (i) Separation of duties of programmer and computer operator

The programmer develops special flowcharts for the application, prepares computer instructions, tests the programme, and documents the results. [1 mark]

The computer operator is responsible for running data through the system in conjunction with the computer programme. [1 mark]

It is important that the programmer does not have access to input data or computer operations, since understanding of the programme can easily be used for personal benefit. [1 mark]

- (ii) Separation of duties of programmer and librarian

The librarian is responsible for maintaining the computer programmes, transaction files, and other important computer records. The librarian provides a means of important physical control over these records and releases them only to authorised personnel. [1 mark]

It is important that the programmer does not have access to transaction files, otherwise there is a risk that the programmer can manipulate the computer records for personal benefit. [1 mark]

(5 marks)

(Total 20 marks)

3.

Internal Control Weaknesses	Recommendations
(1) No credit checking on customers has been performed before the shipment of goods. The company may suffer financial losses due to bad debts. [1 mark]	All credit sales should be approved by the credit department prior to shipment. [1 mark]
(2) The adoption of the sales order number as the sales invoice number is not appropriate because the sales order may not be fulfilled in sequence, or there may be back-orders or insufficient goods to satisfy an order. As a result, the sales invoice issued may not be in sequence. [1 mark]	The sales invoice number should be independent from the sales order number and be pre-numbered in serial order. [1 mark]
(3) There is no independent checking on the arithmetical accuracy as to prices, discounts allowed, extensions and totals. The amount on sales invoice may be incorrectly stated. [1 mark]	An independent check on the arithmetical accuracy should be performed in order to ensure the customer is properly billed. [1 mark]
(4) The accounting department may overstate the sales amount as the posting of sales is based on sales order No. 2. It is probable that sales are recognised before the goods are shipped. [1 mark]	The accounting department should post the sales amount based on the sales invoice. [1 mark]
(5) There is no check on the quantity of goods packed. Discrepancies may occur between the quantity of goods packed and the quantity of goods ordered. [1 mark]	The shipment clerk should be responsible for counting the quantity of goods packed by the storekeeper. [1 mark]
(6) There is no segregation of duties in the cash sales office. It is easy for the clerk to misappropriate cash proceeds. [1 mark]	The company should either consider moving the cash sales office to the sales department or tightening the internal controls on the cash sales office. [1 mark]
(7) The clerk does not register each individual cash sales transaction in the cash register. [1 mark]	Each individual cash sales transaction should be recorded in the cash register at the time of sales, and the sales proceeds should be deposited in the cash register. [1 mark]
(8) Sales proceeds are not promptly banked. [1 mark]	Sales proceeds should be banked on a more frequent basis, such as daily or weekly. [1 mark]

Internal Control Weaknesses**Recommendations**

- | | |
|--|---|
| (9) There is no segregation of duties in the annual stock-taking. The clerk is responsible for the custody and sales of the stocks, and there is no independent staff member to check on the quantity of stocks. [1 mark] | An independent employee should carry out annual stock-taking in the cash sales office. [1 mark] |
| (10) There is no internal control to ensure that cash sales are properly and correctly reported to the accounting department. The clerk may understate the cash sales and misappropriate the sales proceeds. [1 mark] | The accounting department should regularly conduct stock-taking in the cash sales office and reconcile the cash sales, quantity sold and stock balance. [1 mark] |

(Total 20 marks)

4.

Audit Procedures	Audit Objectives to be Accomplished
(a) Select a sample of transactions from the cash payments journal and vouch to supporting documents	To verify the occurrence and accuracy of purchases. [2 marks]
(b) Perform year end purchase cut-off test.	To ensure that purchases are recorded at their proper amounts and in the proper accounting period. [2 marks]
(c) Review payments made subsequent to balance sheet date and unpaid invoices.	To ensure that all liabilities have been properly recorded. [2 marks]
(d) Select a sample of goods received note and trace to entries in cash payments journal.	To verify the occurrence of purchases. [2 marks]
(e) Perform analytical procedures, such as review on the level of physical production volume.	To ensure the completeness of creditors. [2 marks]
(f) Select a sample of trade creditors balances and trace to the documentation supporting a transaction or the transactions which give rise to the balances.	To ensure the trade creditors are correctly valued. [2 marks]
(g) Scan the trial balance of creditors ledger for material debit balances.	To ensure material debit balances are identified for separate disclosure. [2 marks]
(h) Scrutinise the purchase journal for large or unusual items.	To ensure that purchases are recorded at their proper amounts and in the proper accounting period. [2 marks]
(i) Sending confirmations to creditors.	To ensure the existence of recorded creditors. [2 marks]
(j) Select suppliers with zero balances for confirmation.	To search for unrecorded liabilities. [2 marks]

(Total 20 marks)

5. (a)

Actions resulting in a failure to comply with the professional ethics**Explanation**

- | | | |
|-------|---|--|
| (i) | The amount of audit fee depends on whether the bank grants a loan. [1 mark] | <p>In all matters relating to the assignment, independence in mental attitude is to be maintained by auditors. [1 mark]</p> <p>To satisfy the standard, Mr Greed must be without bias with respect to the client under audit. Mr Greed has an obligation of fairness to the shareholders, management, and creditors who may rely on the report. [1 mark]</p> <p>Because of the financial interest in whether the bank loan is granted to I-Toy Limited, Mr Greed is independent in neither fact nor appearance with respect to the assignment undertaken. [1 mark]</p> |
| (ii) | Mr Greed hired two accounting students on a part-time basis to conduct the audit. [1 mark] | <p>The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor. [1 mark]</p> <p>It was inappropriate for Mr Greed to hire two students to conduct the audit. The audit must be conducted by persons with proper education and experience in the field of auditing. Although a junior assistant has not completed his formal education, he may help conduct the audit as long as there is proper supervision and review of his work. [1 mark]</p> |
| (iii) | Mr Greed reviewed the set of financial statements drafted by the part-time staff and an unqualified auditor's report was issued thereon. [1 mark] | <p>Due professional care is to be exercised in the performance of the audit and the preparation of the audit report. [1 mark]</p> <p>This standard requires Mr Greed to perform the audit with due care, which imposes on Mr Greed and every staff in Mr Greed's firm a responsibility to observe the standards of field work and reporting. [1 mark]</p> <p>Exercise of due care requires critical review at every level of supervision of the work done and the judgements of the assistants. Mr Greed clearly failed to adhere to this standard. [1 mark]</p> |

(11 marks)

(b)

**Actions resulting in a failure to comply
with the auditing standards
– audit approach**

Explanation

- | | |
|---|---|
| <p>(i) Mr Greed hired two accounting students on a part-time basis to conduct the audit. [1 mark]</p> | <p>The work has to be adequately planned and assistants are to be properly supervised. [1 mark]</p> <p>This standard recognises that early appointment of the auditor has advantages for the auditor and the client. Mr Greed accepted the engagement without considering the availability of competent staff. In addition, Mr Greed failed to supervise the assistants. The work performed was not adequately planned. [1 mark]</p> |
| <p>(ii) Mr Greed instructed them not to spend time reviewing the internal controls, but to focus on tying the account balances to the trial balance and to prepare a set of financial statements with notes to the accounts. [1 mark]</p> | <p>Sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. [1 mark]</p> <p>Mr Greed did not study the system of internal control nor did the assistants conduct such study. There appears to have been no audit examination at all. The work performed was more an accounting service than an auditing service. [1 mark]</p> |
| <p>(iii) Mr Greed reviewed the set of financial statements drafted by the part-time staff and an unqualified auditor's report was issued thereon. [1 mark]</p> | <p>Sufficient, competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmation to afford a reasonable basis for an opinion regarding the financial statements under examination. [1 mark]</p> <p>Mr Greed acquired no evidence that would support the financial statements. Mr Greed tied the account balances to the trial balance and summarised the accounts. Standard audit procedures and techniques were not performed. [1 mark]</p> |

(9 marks)

(Total 20 marks)

6. (a) Section 141(1) of the Companies Ordinance states that it is a statutory duty for auditors of a company incorporated under the Companies Ordinance to make a report to the members of the company on the company's annual financial statements. [1 mark]

Under section 141(3) of the Companies Ordinance, it is the duty of auditors to report on the accounts concerning

- (i) compliance with the provisions of the Companies Ordinance and [1 mark]
- (ii) truth and fairness. [1 mark]

Under section 141(4) of the Companies Ordinance, it is the duty of auditors to report on whether

- (i) proper accounting records have been kept, [1 mark]
- (ii) proper returns have been received from branches not visited by the auditors, and [1 mark]
- (iii) the accounts are in agreement with the books of account and returns. [1 mark]

(6 marks)

- (b) The rights of auditors given under the Companies Ordinance that can empower them to carry out their duties of reporting to the members on the financial statements include:

- (i) the right to access at all times to the books, accounts and vouchers of the company [1 mark] (section 141(5))
- (ii) the right to require from officers (directors and employees) of the company such information and explanations as the auditor thinks necessary to form his opinion [1 mark] (section 141(5))
- (iii) the right to receive notices and attend members' general meetings and to report on any matter which concerns him as auditor [1 mark] (section 141(7))
- (iv) it is an offence and an officer of the company is liable to imprisonment and a fine for knowingly or recklessly making a misleading, false or deceptive statement to the auditor of the company (whether orally or in writing). [1 mark] (section 134)

(4 marks)

- (c) The rights of auditors upon resignation given under the Companies Ordinance include:

- (i) for the auditors to have the company send a statement of circumstances connected with their resignation or a statement of no such circumstances to the members or creditors within 14 days [1 mark] (section 140A(3)(b))
- (ii) to request an extraordinary general meeting held for circumstances surrounding the resignation [1 mark] (section 140B (1))
- (iii) to receive notices of, attend and be heard as a former auditor in the general meetings:
 - at which his term of office would otherwise have expired
 - at which it is proposed to appoint a new auditor, and
 - the EGM which he has requisitioned [1 mark] (section 140B (5))

- (iv) to have the company send a statement of circumstances to the members in advance of the meetings mentioned in (iii) above; or to have such a statement read out at the meeting **[1 mark]** (section 140B (2) and (3))

(4 marks)

- (d) In determining a reasonable standard of care for an auditor, the factors to be considered include:
 - (i) applying the most up to date accounting and auditing standards **[1 mark]**
 - (ii) adhering to all standards of ethical behaviour laid down by the relevant professional institutes **[1 mark]**
 - (iii) being aware of the terms and conditions of his appointment as set out in the engagement letter and as implied by law **[1 mark]**
 - (iv) employing competent staff who are adequately trained and supervised in carrying out their duties **[1 mark]**

(4 marks)

- (e) Auditors should distinguish between their responsibilities and those of the directors by including in their report:
 - (i) a statement that the financial statements are the responsibility of the reporting entity's directors, and **[1 mark]**
 - (ii) a statement that the auditors' responsibility is to express an opinion on the financial statements. **[1 mark]**

(2 marks)

(Total 20 marks)

– END –

Note: The suggested answer in this paper is longer and in greater detail than would be expected from a student in the examination. However, it may not include all valid points mentioned by students - credit should be given to students mentioning these points.