



ASSURANCE SAMPLE PAPER 2016

QUESTIONS

- 1 Which ONE of the following best describes the concept of assurance?

Assurance refers to

- A An assurance firm's high level of satisfaction as to the reliability of an assertion being made by one party for the use of another party
 - B An assurance firm's satisfaction as to the reliability of an assertion being made by one party for the use of another party
 - C A user's satisfaction as to the reliability of an assertion being made by another party
 - D An assurance firm's limited level of satisfaction as to the reliability of an assertion being made by one party for the use of another party
-

- 2 Which ONE of the following is NOT a benefit of an assurance report on financial information?

An assurance report

- A Enhances the credibility of the information being reported upon
 - B Reduces the risk of management bias in the information being reported upon
 - C Attests to the correctness of the information being reported upon
 - D Draws the attention of the user to deficiencies in the information being reported upon
-

- 3 In any assurance engagement there are three parties involved: the responsible party, the practitioner and the user.

In respect of given subject matter state which party

Prepares the subject matter

- A Responsible party
- B Practitioner
- C User

Gathers evidence on the subject matter

- D Responsible party
 - E Practitioner
 - F User
-

- 4 The following is an extract from an independent accountant's unmodified report on a profit forecast:
- 'Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the forecast.'

Which ONE of the following BEST describes the type of assurance provided by this statement?

- A Positive assurance expressed negatively
 - B Negative assurance expressed positively
 - C High level of assurance expressed negatively
 - D Limited level of assurance expressed negatively
-

- 5 In the context of a statutory audit which THREE of the following are examples of the expectation gap?
- The belief that

- A The auditor's report certifies the financial statements as correct
 - B The auditor's principal duty is to detect fraud
 - C The auditor is employed by the directors
 - D The auditor checks all transactions
-

- 6 The level of assurance given by an assurance engagement will depend on the type of engagement.
- For each of the following examples select what level of assurance you would expect to be given.

Statutory audit

- A Absolute
- B Reasonable

Review of financial information

- C Reasonable
- D Limited

Report on profit and cash flow forecasts

- E Reasonable
 - F Limited
-

- 7 Which THREE of the following are purposes of a letter of engagement?

- A Setting out the form of any report to be issued
 - B Providing constructive suggestions to management concerning improvements in internal control
 - C Documenting and confirming acceptance of the appointment
 - D Narrowing the expectation gap
 - E Providing evidence on matters where other evidence is not expected to exist
-

8 Which ONE of the following best describes professional scepticism?

The assurance provider should

- A Not believe anything that management tells him
 - B Not believe anything that management tells him, without obtaining supporting evidence
 - C Apply a questioning mind to the information and evidence he obtains
 - D Always assume the worst outcome in cases of uncertainty
-

9 For each of the following statements select whether they are true or false in respect of the concept of materiality.

Materiality depends only on the monetary amount of an item

- A True
- B False

Materiality may depend on either the nature of an item or its monetary amount

- C True
- D False

Materiality is a matter of professional judgment

- E True
 - F False
-

10 Audit risk can be split into three components: inherent risk, control risk and detection risk.

For each of the following examples select the type of risk illustrated.

The organisation has few employees in its accounting department

- A Inherent
- B Control
- C Detection

The organisation operates in a fast-moving, high-tech environment

- D Inherent
 - E Control
 - F Detection
-

11 Which THREE of the following would be the best sources of information about a company's systems?

- A The company's procedures manual
 - B The internal audit function's system notes
 - C The prior year audit file
 - D Inquiries made of company staff
 - E The company's website
-

12 Which TWO of the following are reasons why organisations need to have effective systems of control?

To assist the organisation in

- A Minimising business risks
 - B Maximising its profitability
 - C Managing its assets and liabilities
 - D Cutting down the time needed for the audit
 - E Complying with laws and regulations
-

13 An effective system of internal control requires segregation of basic functions. Which THREE of the following functions should ideally be segregated?

- A Authorisation of transactions
 - B Preparation of financial statements
 - C Custody or handling of assets
 - D Budgetary control
 - E Recording of transactions
-

14 An audit committee is a committee with responsibility for audit related matters.

Which ONE of the following should be members of an audit committee?

- A Executive directors only
 - B Non-executive directors only
 - C Non-executive directors and internal auditors
 - D Non-executive directors and external auditors
-

15 ISA 315 states that an internal control system in an organisation consists of five components: the control environment, the entity's risk assessment process, the information system, control activities and monitoring of controls.

For each of the following examples select the component which it illustrates.

The entity's organisational structure

- A Control environment
- B Control activity
- C Monitoring of controls

Review by management of monthly bank reconciliations

- D Control environment
 - E Control activity
 - F Monitoring of controls
-

- 16 The following are examples of internal controls which operate at Fairweather plc. For each example select the type of control activity which it illustrates.

The financial accountant signs the bank reconciliation, which has been prepared by a member of his staff

- A Authorisation
- B Performance review

The finance director compares monthly expenditure on consumables to budgeted expenditure

- C Authorisation
 - D Performance review
-

- 17 Most entities make use of IT systems for financial reporting and operational purposes. Controls operating in an IT environment can be split into general controls and application controls.

Which ONE of the following is an application control?

- A Use of passwords
 - B Testing of new systems
 - C Authorisation of data for input
 - D Disaster recovery plan
-

- 18 Which TWO of the following will reduce password effectiveness as a means of restricting access to a computer system?

- A Frequent changes of passwords
 - B User selection of passwords
 - C Automatic disconnection after failed attempts to access system
 - D Disciplinary offence if passwords revealed
 - E Displaying the password on screen
-

- 19 The following describes the processes which make up the sales system in operation at Raffles and Co.

For each process select whether it represents a strength or a deficiency in the system.

Orders are placed by telephone. On receipt of a call, following credit checks, the order is immediately entered onto the system.

- A Strength
- B Deficiency

The order generates a despatch note which is forwarded to the warehouse and an invoice which is forwarded to accounts receivable. Goods in inventory are despatched immediately and the despatch note is amended manually for unavailable goods.

- C Strength
- D Deficiency

A copy of any despatch notes with incomplete orders is filed in an 'unfulfilled orders' file which is reviewed daily and the backlog filled as soon as inventory is available.

- E Strength
 - F Deficiency
-

20 The following describes the processes which make up the purchases system at Hawthorns and Co.

For each process select whether it represents a strength or a deficiency of the system.

Orders are placed by department heads, usually by telephone, when they determine a service is required.

- A Strength
- B Deficiency

Invoices for services are checked against the service provider's proof of delivery of service, which is requested from every service provider.

- C Strength
- D Deficiency

Payments are made by direct transfer. The direct transfer list is authorised by the financial controller, who verifies the payments to supporting documents, such as the invoice or service agreement.

- E Strength
 - F Deficiency
-

21 Spoon Ltd is a company that is expanding rapidly and is regularly taking on new employees. The payroll is processed in-house in the accounts department using a PC. The financial controller is concerned that fictitious employees could be included on the payroll by an unscrupulous employee from the accounts department.

Which ONE of the following internal controls is MOST likely to PREVENT this from happening?

- A Payroll standing data periodically printed out and checked on a line-by-line basis to independently held employee details
 - B Use of hierarchical passwords over standing data files
 - C Pre-authorisation of all amendments to payroll standing data by an independent official
 - D Supervision of the wages payout by an independent official
-

22 Which TWO of the following control procedures will reduce the risk of unauthorised disclosure of payroll data?

- A Exception reporting of high amounts of net pay
 - B Access controls
 - C Back-up procedures
 - D Encryption of data
 - E Independent review of payroll
-

- 23 The scope and objectives of the internal audit function vary widely and depend on the size and structure of the entity and the requirements of its management.

Which THREE of the following functions could internal audit perform and still operate effectively?

- A Examination of financial and operational information for management
 - B Authorisation of transactions in excess of limits set by management
 - C Review of accounting systems and related controls
 - D Advising management on cost effective controls for systems and activities
 - E Routinely preparing bank reconciliations
-

- 24 The assurance provider will prepare documentation in relation to the fieldwork carried out on an assurance engagement.

For each of the following select whether or not they are valid reasons for preparing such documentation.

To assist in establishing the overall audit strategy for this year's engagement

- A Valid
- B Not valid

To assist in this year's review process

- C Valid
- D Not valid

To provide a record of evidence gathered to support the conclusions reached

- E Valid
 - F Not valid
-

- 25 Which ONE of the following procedures would be the most appropriate for verifying the interest accrued on borrowings?

- A Confirming the interest rate with the lender
 - B Vouching the payment of interest on the borrowings
 - C Testing internal controls over cash payments
 - D Recalculating the interest accrued on the basis of outstanding amount, interest rate and period to which it relates
-

- 26 In respect of an assurance engagement which ONE of the following is the LEAST persuasive method of gathering evidence?

- A Inspection of a supplier's invoice
 - B Reperformance of a supplier statement reconciliation obtained from the client
 - C Reperformance of a depreciation calculation undertaken by the reporting accountant
 - D Inspection of a sales invoice produced by the client
-

27 All methods of obtaining evidence have deficiencies. Examples of such deficiencies are listed below.

For each deficiency select the method of obtaining evidence which is most likely to result in that deficiency.

Limited to the point in time it takes place

A Analytical review

B Observation of a procedure

Limited by underlying accounting system

C Analytical review

D Observation of a procedure

A balance which is overstated may be agreed because it favours the respondent

E Direct confirmation of a receivables balance

F Direct confirmation of a payables balance

28 For each of the following situations select the MOST appropriate approach which should be used by the assurance firm in the given circumstance.

The audit of a new client, recently started up, with few employees in its accounting department

A Tests of control only

B Substantive procedures only

C A mix of tests of control and substantive procedures

The audit of a long-standing client with a sophisticated IT system and an internal audit department

D Tests of control only

E Substantive procedures only

F A mix of tests of control and substantive procedures

29 When determining a sample size for tests of details there are a number of factors which an auditor should take into account.

For each of the following factors select whether it would cause the sample size to increase or to decrease.

An increase in the auditor's assessment of the risk of material misstatement

A Increase

B Decrease

An increase in the use of analytical procedures to test the same assertion

C Increase

D Decrease

An increase in the level of misstatements that the auditor expects to find when testing the assertion

E Increase

F Decrease

- 30 Which TWO of the following are purposes of a written representation letter?
- A Acknowledgement that management has fulfilled its responsibility for the preparation of the financial statements
 - B Provision of evidence in respect of material items where other evidence is available
 - C Acknowledgement by management of its belief that the aggregate of uncorrected misstatements are immaterial to the financial statements
 - D Confirmation by management of the scope of the work to be carried out by the assurance firm
 - E To provide details of proposed modifications to the auditor's report
-

- 31 Two types of procedures used in gathering evidence are tests of controls and substantive procedures. For each of the following examples select the type of procedure illustrated.

Examining the instructions issued by an organisation for its year-end physical inventory count

- A Test of control
- B Substantive procedure

Observing an organisation's despatch procedures

- C Test of control
- D Substantive procedure

Comparing this year's sales figures to those of previous years

- E Test of control
 - F Substantive procedure
-

- 32 The following are examples of tests which an assurance firm might use at the gathering evidence stage of an assignment.

For each example select the type of procedure which that test illustrates.

Casting the list of year-end receivables

- A Confirmation
- B Recalculation
- C Reperformance

Using CAATs to check the ageing of the year-end list of aged receivables

- D Confirmation
 - E Recalculation
 - F Reperformance
-

- 33 In order to gather sufficient, appropriate evidence, the auditor may make use of external confirmation requests.

For each of the following statements with regards to external confirmation requests select whether it is true or false.

A positive confirmation request always asks the respondents to reply to the auditor indicating whether or not they agree with the information provided

- A True
- B False

A sample of confirmation requests drawn from the client's list of balances is more appropriate for receivables balances than for payables balances

- C True
- D False

A positive confirmation request ordinarily provides more reliable audit evidence than a negative confirmation request

- E True
 - F False
-

- 34 Which ONE of the following financial statement assertions will be supported by a sample check on the numerical sequence of despatch notes and invoices?

- A Allocation
 - B Occurrence
 - C Completeness
 - D Valuation
-

- 35 Which ONE of the following procedures should be undertaken to confirm the existence of cash at bank?

- A Inspecting the bank reconciliation statement prepared by the client
 - B Agreeing the figures on the bank reconciliation to the bank column in the cash book
 - C Obtaining direct confirmation of the bank balance from the client's bank
 - D Reperforming the additions on the bank reconciliation
-

- 36 The auditor of Raindrop Ltd carried out a receivables circularisation at the year end to confirm the accuracy of total trade receivables in the statement of financial position at that date. Two of the replies to the circularisation disagreed the balance.

For each of these two disagreements select whether the disagreement would be considered a misstatement for the purpose of evaluating the accuracy of total trade receivables in the statement of financial position at the year end.

Jones and Co disagreed the balance because their records indicated that the amount had been paid a few days before the year end. The auditor's enquiries revealed that the cheque was cleared shortly after the year end

- A Misstatement
- B Not misstatement

Sunny plc disagreed the balance because its records indicated that it had paid the balance two weeks prior to the year end. The auditor's enquiries revealed that the amount had been received and credited to another customer's account prior to the year end

- C Misstatement
 - D Not misstatement
-

- 37 The external auditor of Aaron Ltd has set materiality thresholds such that items under £40,000 are not generally considered material.

For each of the following items in Aaron Ltd's financial statements select whether the auditor would test it primarily for overstatement or primarily for understatement, or whether the item would not be tested at all.

£1,000 due from Harry, a director of Aaron Ltd

- A Overstatement
- B Understatement
- C Not test

Sundry income £35,000

- D Overstatement
 - E Understatement
 - F Not test
-

- 38 Gamma Ltd has a head office and several branches. The head office operates a continuous inventory counting system which ensures that all items are counted at least twice a year and checked against inventory records.

During the interim audit, an examination of the counts undertaken by head office staff shows that differences between inventory records and the physical count regularly arise. Usually, actual inventory levels at branches are found to be higher than book inventory.

Which of the following explains this difference?

- A Unrecorded write offs of scrapped inventory
 - B Unrecorded purchase returns
 - C Unrecorded branch requisitions
 - D Unrecorded branch returns
-

- 39 The results of assigned substantive audit tests at Errata plc are set out below. The materiality threshold set for these tests was £1,000.

For each of the following results select the action which should be taken by the audit senior.

No misstatements found

- A Draw conclusion
- B Refer to senior colleague
- C Extend sample

An arithmetic misstatement of £5,000 found

- D Draw conclusion
- E Refer to senior colleague
- F Extend sample

A misstatement of £10 found, sanctioned by the finance director

- G Draw conclusion
 - H Refer to senior colleague
 - I Extend sample
-

- 40 Which ONE of the following describes how an assurance provider would check the existence assertion for a non-current asset?

- A Trace the physical item to the non-current asset register
 - B Trace the physical item to the financial statements
 - C Trace an entry in the non-current asset register to the physical item
 - D Trace an entry in the non-current asset register to the financial statements
 - E Trace an entry in the financial statements to the physical item
-

- 41 There are two main approaches to a code of professional ethics: a rules-based ethical code and a code based upon a set of principles.

Indicate whether the following statements are true or false.

A code based upon a set of principles requires a professional accountant to comply with a set of specific rules

- A True
- B False

A rules-based code requires a professional accountant to identify, evaluate and address threats to compliance with fundamental ethical principles

- C True
- D False

The ICAEW uses a rules-based approach

- E True
 - F False
-

- 42 The following are examples of situations in which Panama and Co, an audit firm with thirty similar medium-sized audit clients, which are non-listed, might need to implement safeguards in order to protect its independence.

For each situation select the most appropriate safeguard or state that there are no safeguards which could reduce the risk to an acceptable level in accordance with Ethical Standards.

One of Panama and Co's clients is a competitor of one of its other clients

- A Separate personnel
- B Fee threshold not exceeded
- C No safeguards possible

Panama and Co has been asked to take on the role of internal auditor at one of its clients and would be responsible for implementing its own recommendations

- D Separate personnel
 - E Fee threshold not exceeded
 - F No safeguards possible
-

- 43 Talland and Co is the external auditor of Huntley plc, a retailer. The managing partner has been called to a meeting with the board of directors of Huntley plc. At that meeting the firm has been asked if it can provide the following non-audit services.

Huntley plc wish to implement a new sales system. They wish Talland and Co to take on a consultancy project whereby the firm will evaluate several possible systems, advise on which system should be selected, and oversee the installation of the new system.

Which ONE of the following sets of threats would arise from the above scenario, if the project was accepted by Talland and Co?

- A Advocacy and management
 - B Management and familiarity
 - C Management and self-review
 - D Advocacy and familiarity
-

- 44 Brown & Co has been invited by Alpha plc, a listed company, and Beta Ltd, a non-listed company, to provide audit and non-audit services. If accepted, the fees would represent in the case of Alpha plc 11% and in the case of Beta Ltd 12% of the gross fee income of the firm.

Assuming Brown & Co wishes to take on as many clients as is permitted by Ethical Standards, which of the following is the most appropriate course of action?

- A Accept both Alpha plc and Beta Ltd as clients
 - B Accept Alpha plc as a client and refuse Beta Ltd
 - C Accept Beta Ltd as a client and refuse Alpha plc
 - D Refuse to take on either Alpha plc or Beta Ltd as clients
-

- 45 Helena and Co is an eight-partner assurance firm which has been asked to consider taking on the statutory audit of two separate companies. The following potential issues have been identified prior to acceptance of any such appointments.

For each of the following potential clients select on what basis the engagement could be accepted, if at all, in accordance with Ethical Standards.

Titania plc, a listed company, which will also require you to prepare the financial statements

- A Do not accept
- B Accept with safeguards
- C Accept with no safeguards

Puck Ltd, whose finance director is the brother of one of the partners at the assurance firm

- D Do not accept
 - E Accept with safeguards
 - F Accept with no safeguards
-

- 46 Two different audit juniors have been asked to carry out the following tasks. In each case you should select the action that the audit junior should take.

An audit junior at Oberon and Co, a large assurance firm, has been asked to join the audit team at a major client to carry out the receivables section of the audit. The junior has not carried out this section of the audit before but has covered it in his training

- A Perform the work
- B Refer to training partner
- C Contact ICAEW telephone helpline

An audit junior at Lear and Co, a sole practitioner audit firm, has been asked to commence the audit of a small manufacturing client. The junior has expressed reservation about this but the practitioner has insisted that he should go out to the client unsupervised at the beginning of the following week

- D Perform the work
 - E Refer to training partner
 - F Contact ICAEW telephone helpline
-

- 47 David, a recently qualified chartered accountant, is the newly-appointed financial controller of Hartpury Ltd. Hartpury Ltd is a relatively small company, which is ripe for takeover.

As one of his first assignments, David has been asked to prepare the financial statements for the year ended 31 December 20X6. David has now been called into the last part of a board meeting where the directors have given him a profit target which must be met in those financial statements. They have stressed that this profit target must be met, even if it means that accounting standards are not followed.

Which TWO of the following describe possible appropriate courses of action which David could consider taking?

- A Report his concerns to the audit committee
 - B Resign his post
 - C Report his concerns to the finance director
 - D Take legal advice
 - E Use Hartpury Ltd's formal dispute resolution process to resolve the issue
-

- 48 The following are examples of situations in which an audit firm might be faced with threats to its independence.

For each example select the principal type of threat which that situation illustrates.

The finance director has a very strong personality and insists on the audit team working in his office

- A Familiarity
- B Intimidation
- C Management

The audit team and the management team at the client have remained unchanged for several years

- D Familiarity
 - E Intimidation
 - F Management
-

- 49 In which ONE of the following situations may confidential information in respect of a client ONLY be disclosed if the permission of the client has first been granted?

- A As a defence in a negligence claim
 - B In order to avoid giving an incorrect audit report to another client
 - C Where money laundering is suspected
 - D Where terrorism is suspected
-

- 50 During the course of an assurance engagement, a member of the assurance team from Endeavour and Co discovers that the owner of the business regularly collects cash received from customers and does not include any details relating to the transaction in the accounting records of the business.

Which ONE of the following is the most appropriate action for him to take in respect of this matter?

- A Discuss the matter with the client and advise him of the legal position
 - B Report the matter to the manager of the assurance engagement so that she can discuss it with the client
 - C Obtain the client's permission to report the matter to a designated officer within your firm
 - D Report the matter to a designated officer within your firm without the client's permission
-



ASSURANCE SAMPLE PAPER 2016

ANSWERS

- 1 B Assurance refers to an assurance firm's satisfaction as to the reliability of an assertion being made by one party for the use of another party. This assurance is then expressed in an assurance report with a negative or positive conclusion given as appropriate to that particular engagement. LO 1a
- 2 C An assurance report does not 'attest(s) to the correctness of the information being reported upon'. Even a reasonable assurance engagement (which gives more assurance than a limited assurance engagement) does not provide a guarantee that the information being reported on is correct. Assurance can never be absolute as this statement implies. LO 1b
- 3 A,E It is the responsible party that prepares the subject matter and the practitioner who is responsible for gathering evidence. The user is the party who receives the final report. LO 1c
- 4 D There are two types of conclusion which can be given: a conclusion expressed in positive terms and a conclusion expressed in negative terms. A conclusion expressed in negative terms is indicated by the phrase 'nothing has come to our attention' which indicates the restricted work carried out and hence the fact that the assurance is limited, as opposed to reasonable. Hence this type of assurance is limited level of assurance expressed negatively. LO1d
- 5 A,B,D
- The expectation gap is the gap between what users of financial statements believe the auditor does and what the auditor actually does. The following three are common manifestations of the expectation gap:
- The auditor's report certifies the financial statements as correct
 - The auditor's principal duty is to detect fraud
 - The auditor checks all transactions.
- The belief that the auditor is employed by the directors is a common misconception but not a manifestation of the expectation gap. (The company employs the auditor, who is appointed by the shareholders in a general meeting.) LO 1e
- 6 B,D,F
- A statutory audit provides reasonable assurance, which reflects the comprehensiveness of the audit procedures carried out. No assurance engagement, not even a statutory audit can give absolute assurance. LO 1d
- 7 A,C,D
- The following are not purposes of an engagement letter:
- Providing constructive suggestions to management concerning improvements to internal control
 - Providing evidence on matters where other evidence is not expected to exist (eg on management plans for the future of the entity) – this is the purpose of a written representation. LO 1f
- 8 C Apply a questioning mind to the information and evidence he obtains would indicate professional scepticism. The alternative options offered are all a step too far. LO 1g

9 B,C,E

False – materiality can be both quantitative and qualitative.

True – materiality may depend on *either* the nature of an item *or* its monetary amount.

True – materiality is determined by the external auditor and he will use his professional judgment in setting a level of materiality which best addresses the audit risk. LO 1f

10 B,D Control – few employees indicates limited segregation of duties, which is a control deficiency.

Inherent – a fast-moving, high-tech environment presents inherent risks both at the company level but also at individual account levels (eg inventory). LO 1f

11 A,B,D

Option C is not correct as whilst the prior year audit file will be useful, the system may have changed in the intervening period. The company's website is very unlikely to contain details on the internal control system. LO 2i

12 A,E Minimising business risks and complying with laws and regulations are the primary reasons why organisations need effective systems of control. The others may result from that effective internal control system. LO 2a

13 A,C,E

Authorisation of transactions, custody or handling of assets and recording of transactions are the three functions which should ideally be separated such that no-one person can initiate the transaction, record that transaction in the accounting records and have custody of assets which arise from that transaction. For fraud to take place, with such segregation of duties, there would have to be significant collusion. Preparing financial statements is a function which follows from the recording of transactions and effective budgetary control can only take place once there is confidence on the integrity of data coming from effective internal control systems. LO 2b

14 B An audit committee is made up of non-executive directors only. LO 2d

15 A,F The entity's organisational structure is part of the entity's control environment. Monitoring of controls involves a review of the effectiveness of controls and whether they need improving – hence a review by management of monthly bank reconciliations is part of that monitoring system LO 2d

16 A,D Authorisation showing that the accountant has reviewed the reconciliation.

Performance review includes reviews and analyses of actual performance against budgets (as here), forecasts and prior period performance. LO 2e

17 C Application controls apply to the processing of individual applications (eg sales, purchases, inventory), hence authorisation of data for input (say of purchase orders) is the application control. The remaining options are general controls, which relate to many applications and support the operation of the whole IT environment. LO 2e

18 B,E User selection of passwords and displaying the password on screen would reduce password effectiveness. The existence of frequent changes of passwords, automatic disconnection after failed attempts and disciplinary offences if passwords are revealed would all *increase* password effectiveness. LO 2f

- 19 A,D,E
 Strength – that orders placed by telephone, once credit checked, are entered into the system is a strength as it ensures the prompt recording of an order. Also the customer is checked for creditworthiness prior to the order being generated – indicating that the company is protecting itself from loss.
 Deficiency – the order should only be accepted once it has been confirmed that the goods ordered are available. The invoice should be generated once it is confirmed that the goods have reached the customer (as evidenced by the customer signing the dispatch note).
 Strength – a copy of any dispatch notes with incomplete orders filed and reviewed daily will ensure that orders are filled at a later date. LO 2g/h
- 20 B,C,E
 Deficiency – there is no authorisation of payment orders.
 Strength – company only recognises liability for services received.
 Strength – payments authorised. LO 2g/h
- 21 B In order to prevent this from happening, the key is that fictitious employees never make it onto the payroll. The financial controller is concerned that an employee from the accounts department, who has the right to access the payroll system, might be so unscrupulous as to add a fictitious employee and gain access to the wages.
- Payroll standing data periodically printed out and checked on a line-by-line basis to independently held employee details – this will *detect* fictitious employees added but will not *prevent* fictitious employees from being added.
 - Use of hierarchical passwords over standing data files – this will allow the company to restrict access to standing data files to a responsible official, yet still allow other employees to process the wages. This means that an unscrupulous employee *cannot* access the part of the system where new employees would be added and hence will prevent the fraud. This is therefore the correct answer.
 - Pre-authorisation of all amendments to payroll standing data by an independent official – an unscrupulous employee will not ask for authorisation – he will simply add the fictitious details if the system allows him to do this.
 - Supervision of the wages payout by an independent official – again, this might detect dummy employees but would be unlikely to prevent the fraud. LO 2f
- 22 B,D Access controls and encryption of data will reduce the risk of unauthorised disclosure. Exception reporting and an independent review of the payroll, would help identify unauthorised changes to payroll information. Back-up procedures would help in the protection of company data. LO 2f
- 23 A,C,D
 Internal audit should not have operational responsibilities so should not authorise transactions or routinely prepare bank reconciliations. LO 2d
- 24 B,C,E
 Not valid – fieldwork documentation does not assist in establishing the audit strategy.
 Valid – fieldwork documentation assists in an effective review process.
 Valid – the fieldwork documentation provides a record of evidence gathered. LO 3a

- 25 D Recalculating the interest accrued on the basis of outstanding amount, interest rate and period to which it relates would be the most appropriate for verification of the interest accrued on borrowings. Confirming the interest rate with the lender would not verify the total interest accrued balance (as the interest rate is only one component of the calculation) nor would vouching the interest payment (as interest paid is not the same as interest accrued). Testing the internal controls over cash payments would not lead to direct verification of the interest accrued. LO 3d
- 26 D Inspection of a sales invoices produced by the client would constitute the least persuasive method of gathering evidence as it is the least reliable of all the options. The supplier's invoice is more reliable as it comes from a third party and reperformance of calculations and reconciliations is also more reliable as this evidence is generated by the assurance provider/reporting accountant. LO 3e
- 27 B,C,F
- The weakness of observation of a procedure is that the conclusion drawn as a result only applies to the system at the time the observation took place – hence it is limited to the point in time it takes place.
- The usefulness of analytical review is limited by the underlying accounting system which generates the balances under review.
- A respondent will agree to an overstated balance if that is direct confirmation in respect of a payables balance (he would disagree if the amount he owed – ie a receivables balance – were overstated). LO 3c
- 28 B,F Substantive procedures only – A new client with few employees implies a lack of segregation of duties and hence high control risk. Therefore reliance should not be placed on the internal control system. Audit evidence should be gathered using substantive procedures.
- A mix of tests of control and substantive procedures may be used for the audit of a long-standing client with a sophisticated IT system and an internal audit department as it will be possible to rely on internal controls and then perform reduced substantive procedures. LO 3f
- 29 A,D,E
- An increase in the auditor's assessment of the risk of material misstatement would cause the sample size to increase as an increase in audit risk can only be addressed and reduced by an increase in the work carried out.
- An increase in the use of analytical procedures to test the same assertion would decrease the sample size, so that the area is not over-audited.
- An increase in the expected misstatements would lead to an increase in the sample size. LO 3g
- 30 A,C Acknowledgement that management has fulfilled its responsibility for the preparation of the financial statements and acknowledgement by management of its belief that the aggregate of uncorrected misstatements are immaterial to the financial statements are the two purposes of the written representation letter from the list provided.
- Where other evidence is available on a matter, the written representation letter does not serve to provide evidence. Management's confirmation of the scope of the work to be carried out is included in an engagement letter. LO 3h
- 31 A,C,F
- Test of control – that the instructions are likely to lead to an accurate count.
- Test of control – that despatch procedures are being properly followed.
- Substantive procedure – remembering that substantive procedures include analytical procedures, which is what this describes. LO 3b

- 32 B,F Recalculation consists of checking the mathematical accuracy of documents or records, therefore casting the list of year-end receivables is a recalculation procedure.
- Reperformance is the auditor's independent execution of procedures or controls which were originally performed as part of the entity's internal control, therefore using CAATs to check the ageing of the year-end list of aged receivables is a reperformance of that ageing analysis, which is itself a control over the recoverability of receivables. LO 3b
- 33 B,C,E
- False – a positive confirmation may take two forms: requesting a response indicating whether they agree or disagree with the information provided, or requesting the recipient to state the amount owed by/to them.
- True – receivables are tested for overstatement therefore it is acceptable to select the sample from the client's list of balances. The direct confirmation would be likely to elicit a response (even if negative confirmation is used) if the balance is indeed overstated. However, payables are tested for understatement and the auditor is looking for balances which are not on the client's list, but should be. Therefore this sample should be drawn from a list of all possible payables, not from the client's list, which may already be understated.
- True – with a positive confirmation, a response is expected whether there is agreement or disagreement. With a negative confirmation, there is an element of uncertainty as to the reasons for non-response. Hence the former is ordinarily more reliable than the latter. LO 3c
- 34 C Completeness – a sequence check will highlight missing documents which may indicate unrecorded transactions – ie test the completeness of sales. LO 3d
- 35 C Obtaining direct confirmation of the bank balance from the client's bank will confirm the existence of the cash at bank with a third party (ie the bank). LO 3d
- 36 B,D Not misstatement – this disagreement stems from a timing difference and, as such, does not indicate a misstatement in the receivables balance.
- Not misstatement – this disagreement stems from a misposting which does not affect the total receivables balance in the financial statements. LO 3g
- 37 A,F Overstatement – the amount is an asset so we test primarily for overstatement. The amount owed is considered irrespective of the materiality threshold due to the nature of the item (director loan).
- Not test – the amount is below the materiality threshold. The likelihood of material fraud or misstatement within the balance is very low. LO 3f/g
- 38 C Actual inventory levels at branches are higher than book inventory – ie there must be unrecorded goods inwards. Only unrecorded branch requisitions (goods coming in from head office) would explain this. All the others would lean to book inventory higher than actual inventory. LO 3g
- 39 A,F,H
- No misstatements are found therefore the appropriate action would be to draw a conclusion.
- An arithmetic misstatement of £5,000 found would be above the materiality threshold and so the auditor should extend his sample.
- A misstatement of £10 found, sanctioned by the FD should lead to the auditor to refer the matter to a senior colleague due to the FD's sanctioning. LO 3i

- 40 C To test for existence the reporting accountant should work from the financial statements to the physical item. However, the financial statements themselves do not contain an analysis of the individual items that make up non-current assets so the reporting accountant will need to select his sample from the non-current asset register (having checked that this record agrees to the financial statements).
LO 3f
- 41 B,D,F
A code based on principles does not contain specific rules for auditor compliance.
A rules-based code does not require auditor adherence to a set of principles.
The ICAEW uses a principles-based approach. LO 4b/d
- 42 A,F By assigning separate personnel to each assignment the confidentiality of each client and hence the auditor's independence will be protected.
An internal audit role cannot be taken on per ES5 where the audit firm would need to rely on their own work (self-review threat) or where the audit firm would take on part of the role of management (Panama and Co would be responsible for implementing their own recommendations – a management threat). Hence there are no safeguards possible. LO 4n
- 43 C Management threat – selection of systems should be carried out by management. If the auditor undertakes this role he becomes too closely aligned with management and this threatens his independence.
Self-review threat – the audit firm will audit the system it has implemented.
There are no indications of a familiarity threat, as no indication is given of the length of the relationship nor of any family or close personal relationships between audit firm and client. LO 4m
- 44 C Accept Beta Ltd as 12% is below the 15% threshold for private companies. Refuse Alpha plc as 11% is above the 10% threshold for listed companies. LO 4f
- 45 A,E Do not accept Titania plc as it is not acceptable to prepare and audit the financial statements of a listed company.
The audit of Puck Ltd can be accepted with safeguards – such as not letting the FD's brother take any part in the audit. LO 4g
- 46 A,F At Oberon and Co, the junior can go ahead and perform the work, given the low risk nature of the receivables balance, and the fact that the junior has covered this in his training. The junior is also to join an audit team, where resources for guidance, supervision and review will also be available.
With regards to Lear and Co, the junior should contact ICAEW telephone helpline. Commencing the audit of a client unsupervised, may lead to exposure of both the junior and the firm to risks. In a larger firm the junior could refer to his training partner, but since this is a sole practitioner firm the practitioner himself must also be the training partner. LO 4h
- 47 B,D David has no other option in this case but to resign his post and take legal advice. Given that these instructions have come from the board of directors, it would seem fruitless to pursue this issue internally. LO 4o
- 48 B,D The FD having a very strong personality may lead to an intimidation threat.
The audit and client team remaining unchanged for many years is likely to lead to a familiarity threat. LO 4m

- 49 B In order to avoid giving an incorrect audit report to another client is the only option where permission must first be granted (otherwise the assurance provider will be breaking his duty of confidentiality to that client). For the other options, client permission is not required (and indeed to seek this could be regarded as 'tipping off' the client) but disclosure is necessary by law or the auditor is protected by the court (eg in a negligence claim). LO 4k
- 50 D Report the matter to a designated officer within your firm without the client's permission. Discussing or mentioning the matter with the client would only serve to tip him off about the transactions identified.

LO 4k