

**UNIT CODE: ACT303
UNIT NAME: PRINCIPLES OF AUDITING**

**Written Assignment Information
Semester 1 2021
Marks and Weight: 70 marks and to be weighted @ 20%
Length: Maximum 3,000 words**

Submission Requirements.

This assignment may be submitted at or before 11.59pm (ACST) Sunday, 9th May 2021, (Study Week 9)

Assignments are to be submitted by one of the following means;

- The assignment must be lodged on or before the due date indicated in the assignment details.
- Submit your Assignment as one document, using PDF or Word doc format¹
- Ensure your file is named using a file naming convention that allows the lecturer to identify to whom it belongs. Failure to use an acceptable file naming convention may result in your assignment lodgement being rejected **(For students working in groups, ONLY the group leader will submit the Assignment - be sure to indicate all the Names and Student Numbers on the front cover/first page).**
- The assignment must conform to the requirements set out in this assignment
- The assignment must be lodged online via the ACT303 Learnline Assignment Lodgement link on the ACT303 Learnline site.
- **DO NOT LODGE VIA EMAIL or FAX - assignments lodged by email or fax will not be accepted.**
- **KEEP A COPY - Ensure you have a copy of the assignment lodged.**

1 Instructions for creating PDF documents and/or combining documents of different formats are provided on the Learnline site.

Online Submission

Students will now be required to affirm at the point of submission that the work they are submitting is their original work. This is built into the submission point.

The submission text reads as follows:

By clicking the SUBMIT button I certify that this assignment is my own work, based on my own personal study and research, and that I have acknowledged all material and sources in the preparation of this assignment, whether they be books, articles reports, lecture notes, images, videos, any other kind of document or personal communication.

I also certify that this assignment has not previously been submitted for assessment in any other course or at any other time in the same course (except as a DRAFT submission) and that I have not copied in part or whole or otherwise plagiarised the work of other students and/or persons.

I have read Charles Darwin University's [Academic and Scientific Misconduct Policy \(pol-001\)](#) and Student Breach of Academic Integrity Procedures <http://www.cdu.edu.au/governance/procedures/pro-092.pdf> and understand its implications.

Format

The assignment may be completed manually, or with the use of an electronic spreadsheet, word processing software or with the use of accounting software. Marks may be deducted for illegible or partially illegible papers. If completed using multiple file formats or manually, **the document must be combined into one document, in PDF format².**

Resubmission

As a general rule resubmission of assessment items is NOT possible, however the Lecturer may ask for resubmission if it is deemed appropriate. Details for such resubmission will be made available by the Lecturer if and when the situation occurs.

Oral Test or Viva Voce

Lecturers may, at their discretion, ask students to verbally present their assignment submissions or rewrite some selected part/s of their answer in a controlled setting.

Lecturers may exercise this discretion where they feel that the assignment was not the student's own work.

University Plagiarism policy!

Plagiarism is the unacknowledged use of material written or produced by others or a rework of your own material. All sources of information and ideas used in assignments must be referenced. This applies whether the information is from a book, journal article, the internet, or a previous essay you wrote or the assignment of a friend.

Plagiarism policy is available at:

<http://www.cdu.edu.au/governance/policies/pol-001.pdf> and Student Breach of Academic Integrity Procedures <http://www.cdu.edu.au/governance/procedures/pro-092.pdf>

2 Instructions for creating PDF documents and/or combining documents of different formats are provided on the Learnline site.

Extensions and Late Lodgements

LATE ASSIGNMENTS WILL GENERALLY NOT BE ACCEPTED UNLESS AN EXTENSION TO THE DUE DATE HAS BEEN GRANTED BY THE HEAD OF SCHOOL.

Exceptions will only be made where assignments are late due to special circumstances that are supported by documentary evidence, and may be subject to a **penalty of 5% of assignment marks per day**. Partially completed assignments will be accepted with appropriate loss of marks for the incomplete portion.

Should students foresee potential difficulties with submission of assessment items, they should contact the lecturer immediately the difficulties come to notice, to discuss suitable arrangements etc for the submission of those assessment times. An Application for Assignment Extension or Special Consideration should be completed and provided to the Head of School, School of Law and Business.

This application form, explanation and instructions is available on the ACT303 CDU Learnline course site or direct from

http://learnline.cdu.edu.au/units/lb_school_templates/deployed/assignment_extension.docx

Please note that it is now Faculty policy that all extension requests must be approved by the Head of School. The lecturer is no longer able to personally approve extension requests.

Leaving a request for an extension, special assessment or special consideration until the last moment, based on grounds that students could have reasonably been able to foresee, may result in the application being rejected.

Ensure that you maintain suitable backup copies of your assignment during preparation, before completion and after lodgement. Loss of data/assignment due to failure to maintain a suitable backup will not constitute grounds for an extension.

QUESTION 1 (20 MARKS)

Case 1

During the financial year 2020/2021, you are one of the audit partners with Summit and Associates CAs, a large and experienced audit firm.

You have been approached to accept the audit of Chem Safe Ltd (Chem Safe), a medium-sized chemical manufacturer. The manufacture of the chemicals results in highly toxic waste and Chem Safe is currently under investigation by the Environmental Protection Agency for a significant spill of toxic chemicals into a nearby river. The media have reported that senior employees were allegedly involved in trying to cover up the spill.

Required:

Identify and explain the key ethical matter regarding Chem Safe and its management that you should consider before making the decision to accept the engagement. (2 Marks)

Case 2

Chem Safe Ltd (Chem Safe) imports a number of pharmaceutical products. In order to hedge its foreign currency transactions, Chem Safe entered into a number of forward rate agreements this year. Prior to this time Chem Safe had had little exposure to derivative instruments, but a series of bad experiences resulting from fluctuating exchange rates convinced the company that a hedging strategy was necessary. During planning for the audit of Chem Safe, the company's hedging arrangements were identified as inherently risky and increased testing was carried out in this area. A number of small errors were noted in accounting for hedge transactions, but there did not appear to be any material errors and as such no adjustments were made. A review of the audit file suggests that the errors noted were a result of inexperience and poor controls in the area. While all of the errors were brought to the attention of the treasurer, who is responsible for the company's hedging strategy, no further action has been taken to date.

Required:

Outline what further action the auditor should take in response to the errors and control weaknesses identified. Justify your response. (2 Marks)

Case 3

Summit and Associates CAs has agreed to take on a new audit client, Reaction Pty Ltd, a small garage door manufacturer that has never previously been audited. Summit and Associates CAs has issued an engagement letter prior to commencing work for the current year. While conducting the audit, the audit team is unable to gain sufficient appropriate audit evidence around accounts receivable due to a lack of documentation. You have informed client management that you need to issue a modified auditor's report due to the scope limitation. In response, management has requested that the engagement become a review engagement with the associated lower level of assurance, as they are not required to have an audit.

Required:

Outline the appropriate response to this situation. Provide reasons to support your response. (4 Marks)

Case 4

Consider the following independent situations:

1. You are the auditor of Hail Pty Ltd a medium sized furniture manufacturer. Your audit firm has finalised the financial statements after the client has substantially prepared the accounting records. However, the client admits to having limited knowledge of identifying and calculating impairment and has asked for your assistance. You have proposed a number of adjustments to account for the impairment of assets.
2. You are the auditor of Travel Time Ltd, a large travel agent that also handles all your audit firms travel arrangements on normal commercial rates and provides excellent service. The managing director of Travel Time has indicated that the company is having a tough time of it due to the lack of consumer confidence in the economy at the moment and has asked if you could help by recommending their services to your other audit clients. He has said that he will understand if you are not able to do so. You happily agree to provide the recommendation, as you have always been satisfied with their service.
3. Your audit firm has been approached by a new client, Civil Constructions Ltd, to conduct the audit for the coming year. As part of your client acceptance procedures, you identify that the wife of one of the audit firm's partners has a substantial shareholding in Civil Constructions Ltd.
4. Your audit client, Pleasure Cruises Ltd, is having cash flow problems and has not paid any of the current year's fee by the time the auditor's report is due to be issued. They expect business to pick up in the coming year and have requested an additional time to pay the bill.

Required:

For each of the independent situations above:

- a) Identify the type of potential threat to independence. Justify your answer. (8 marks)
- b) Describe a safeguard, if any, which could be implemented to reduce each of the independence threats. (4 marks)

[2 + 2 + 4 + 8 + 4 = 20 marks]

QUESTION 2 (10 MARKS)

Case Background

You are the audit senior on the audit of Best Furniture Manufacturers Pty Ltd (Best). Your firm has recently been appointed as the first auditors of the company.

You interview the managing director of the company to obtain background information on Best and to understand its business operations, its environment and system of internal control. You noted and documented the following:

- Best was founded 30 years ago and makes 'grandfather' clocks (freestanding, weight driven, pendulum clocks).
- The clocks are made in one factory (situated in the Alice Springs) and are distributed through boutique homeware and antique furniture stores.
- The clocks are advertised mainly in local newspapers and through pamphlet drops.
- In order to promote longer production runs and minimise finished goods stocks, Best's retail distributors are offered stock on a 'sale or return' basis. This means that the homeware and antique furniture stores are invoiced immediately, subject to a 90-day term of payment, but are allowed to return the stock up to 30 days before payment is due. Only the marketing manager has been given the authority to make these offers.
- All of Best's timber is obtained from offshore sources. Timber prices, which are denominated in US dollars, have risen substantially over the past two years and the recent drop in the value of the Australian dollar has caused them to rise even further.
- Timber purchases are secured by providing Best's suppliers with letters of credit which become due when the container shipment of timber arrives in Australia.
- Labour costs are high due to the craftsmanship and quality required for the production of the grandfather clocks. Skilled labour is not easy to obtain and wage rates have recently risen.
- Best has found it difficult to pass on these timber and labour price increases to customers.

An analysis of costs indicates that there have been material negative purchase price variances in purchases of timber over the course of the year. You have compiled the following information from Best's financials:

- the current ratio as at 30 June 2020 is 1.24
- the shareholders' funds to total assets ratio is 30%
- gross profit margins and net profit margins for the year ended 30 June 2020 have dropped to the level where losses are being incurred.

NB: An excerpt of Best's Financial Reports is attached.

| Best Furniture Manufacturers Pty Ltd (Best) | | | |
|--|------------------|------------------|------------------|
| Balance Sheet | | | |
| | 2020 | 2019 | 2018 |
| Current assets | | | |
| Debtors | 748,681 | 774,469 | 665,939 |
| Sale or return debtors | 483,020 | 499,657 | 429,638 |
| Inventory | 300,035 | 305,013 | 256,376 |
| | 1,531,737 | 1,579,140 | 1,351,953 |
| Non-current assets | | | |
| Property, plant and machinery | 1,967,404 | 1,993,058 | 1,867,593 |
| | | | |
| Total assets | 3,499,141 | 3,572,198 | 3,219,546 |
| Current liabilities | | | |
| Trade and other creditors | 395,019 | 343,545 | 289,049 |
| Bills payable | 509,494 | 517,947 | 435,355 |
| Bank overdraft | 135,576 | 13,337 | 55,672 |
| Current portion of bank loans | 200,000 | 200,000 | 200,000 |
| | 1,240,090 | 1,074,830 | 980,076 |
| Non-current liabilities | | | |
| Bank loans | 1,200,000 | 1,400,000 | 1,600,000 |
| Equity | | | |
| Share capital | 500,000 | 500,000 | 500,000 |
| Retained earnings | 559,051 | 597,368 | 139,470 |
| | 1,059,051 | 1,097,368 | 639,470 |
| | 3,499,141 | 3,572,198 | 3,219,546 |
| Profit and Loss Account | | | |
| Gross sales | 6,077,296 | 6,233,124 | 5,350,321 |
| Returns | - 200,551 | - 153,958 | - 123,057 |
| Net sales | 5,876,745 | 6,079,166 | 5,227,264 |
| Cost of sales | | | |
| Materials | 2,066,281 | 2,100,563 | 1,765,606 |
| Labour | 1,397,778 | 1,153,128 | 963,058 |
| Other | 516,570 | 506,130 | 438,726 |
| | 3,980,629 | 3,759,820 | 3,167,390 |
| Standard Cost Variances | | | |
| Purchase price | (121,546) | (49,865) | (16,051) |
| Labour cost | (182,319) | (62,331) | (26,136) |
| | (303,865) | (112,196) | (42,187) |
| Operating profit | 1,592,252 | 2,207,149 | 2,017,686 |
| Expenses | | | |
| Administration | 791,918 | 754,208 | 600,841 |
| Sales and marketing | 663,198 | 642,012 | 524,331 |
| Financing | 175,452 | 156,789 | 123,457 |
| | 1,630,569 | 1,553,009 | 1,248,630 |
| Net profit (loss) | (38,317) | 654,140 | 769,057 |
| Tax | 0 | 196,242 | 230,717 |
| Net profit after tax (loss) | (38,317) | 457,898 | 538,340 |

Best's bank finances the company's timber purchases using bills of exchange drawn at 90 days from the date of payment of the shipment. It has also extended loan finance to Best. The bank covenant, which is due for review shortly, requires Best to:

- maintain a current ratio of 1.2
- maintain a shareholders' funds to total assets ratio of at least 30%
- maintain net sales of a minimum of \$100,000 per quarter
- prepare a general purpose financial report for the year ended 30 June 2020 and have it audited according to Australian Auditing Standards. Note that this is a requirement of the bank covenant as Best is not required to produce a general purpose financial report under the Corporations Act.

Required:

Based on the background information above and your use of preliminary analytical procedures, answer the following questions:

- a) Identify and explain two (2) asset accounts at risk of material misstatement (4 marks).
- b) Describe one (1) issue regarding the prior year's figures and explain why (2 marks).
- c) Describe two factors that may bring into question the going concern assumption for Best. (2 marks)
- d) Disregarding the evaluation of management's assessment of the going concern assumption, briefly describe the effect of the facts on your audit planning (2 marks).

[4 + 2 + 2 + 2= 10 marks]

QUESTION 3 (10 MARKS)

Background

Safe Net is the wealth management division of Security Bank (Security) and provides investment, superannuation, insurance and private wealth solutions to corporate and institutional customers. The following is a list of the auditor's planning file notes in relation to fraud detection for the audit of the Safe Net unit.

1. Ensure all material fraud instances are detected.
2. The auditor is responsible for maintaining professional scepticism throughout the audit, considering the potential for management override of controls and recognising the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.
3. Respond appropriately to fraud or suspected fraud identified during the audit.
4. A discussion among all of the audit firm's staff on how and where the entity's financial statements may be susceptible to material misstatements due to fraud, including how fraud might occur.
5. Make enquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.
6. Obtain sufficient appropriate audit evidence to confirm all potential fraud instances have been uncovered and their impacts considered.
7. Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
8. Determine whether management has sufficient skills to prevent and detect fraud (e.g. through proof of attendance at appropriate industry seminars and workshops, or past experience with fraud).
9. Obtain a copy of the client's code of ethics document, and ensure employees have access to it.
10. Evaluate whether the accounting policies selected by the entity may be indicative of fraud.

REQUIRED:

Identify the activities that are part and the activities that are not part of the auditor's responsibilities relating to fraud under ASA 240.

[10 marks]

QUESTION 4 (30 MARKS)

*NOTE: In answering this Question, use APA referencing style and support your answers with relevant accounting and auditing standards as well as published peer-reviewed academic journals. **A minimum of 5 peer-reviewed academic journals is expected.** (Hint: this is a great opportunity to utilise the University's Library Services online such as Library Search, Advance Search, eJournals and Databases such as EBSCOhost, etc.)*

You are expected to support your answers with the relevant Australian Accounting Standards and Australian Auditing Standards and with authorised/published Peer-reviewed Academic Journals and Articles.

Case Background

In February 2012, the Australian Accounting Standards Boards decided at its meeting to propose the withdrawal of *AASB 1031 Materiality*. There were several reasons for this proposal which includes: there is no International Reporting Standard equivalent and it does not look like there will be, since 2005 there has been the gradual withdrawal of additional Australian guidance from a number of Australian Accounting Standards, and there is now an updated guidance on materiality in the *IASB Conceptual Framework*.

The major impact of the withdrawal of *AASB 1031* is the removal of the *specific quantitative guidance for materiality*. The withdrawal of *AASB 1031* became effective to annual reporting beginning on or after 1 July 2015.

Required:

- A. Prior to the withdrawal of *AASB 1031* and with reference to the ***AASB 1031 Materiality*** (issued by the Australian Accounting Standards Boards - AASB) and the ***ASA 320 Materiality in Planning and Performing an Audit*** and ***ASA 450 Evaluation of Misstatements Identified during an Audit*** (issued by the Auditing and Assurance Standards Board – AUASB):**
- What is materiality as per the Accounting Standards and Auditing Standards? (3 marks)
 - Outline the **qualitative** and **quantitative** guidelines of materiality as per the Accounting Standards and Auditing Standards. (6 marks)
 - Before the removal of *AASB 1031*, how do the standards and guidelines of “materiality” influence the auditors’ judgment on materiality level and material misstatements? Provide examples. (6 marks)
- B. Post withdrawal of *AASB 1031*, and with supporting academic research articles in accounting/auditing research in materiality, would the removal of *AASB1031 Materiality* Standards:**
- harmonise/bring uniformity/homogeneity to auditors’ assessment of materiality misstatements or would this bring disparity/heterogeneity to auditors’ assessment of misstatements? Explain your answer. (6 marks)
 - What other factors or influences, if any, the removal of *AASB 1031* would impact the auditors’ judgment on materiality? Explain your answer. (4 marks)
 - What are the implications this would have on the usefulness of financial reports? Discuss your answer and rationale. (5 marks)

[15 + 15 = 30 marks]

***** End of Assignment*****