

SECTION A

QUESTION ONE

Your firm has recently been appointed auditor of Tours Ltd for the year ended 30 June 2006 and in preparation for your first audit you have obtained the following background information.

The company operates a fleet of coaches to take visitors in London on guided day trips to tourist attractions outside the capital. All of the shares are owned by the managing director Polly Lunn.

The company has a centre in London where customers can buy tickets on the day, but over half its business comes from holiday companies who book their clients onto tours in advance and the large hotels who offer their booking service to guests. Individual customers must pay by cash or credit card. Holiday companies and hotels are invoiced at the end of each month.

In recent years the company's vehicles suffered a high level of breakdowns and mechanical failures, one of which led to an accident in which a number of passengers were injured. As a result the company has replaced the bulk of its fleet with new coaches. These acquisitions were funded by leasing. The only entries in the accounting records in respect of the lease transactions have been the payment of the monthly rentals to the leasing company. Under the terms of the leases, Tours Ltd is responsible for the repairs and maintenance of the coaches and all of this work is undertaken by Rapid Repairs Ltd, a company in which Polly Lunn has a majority shareholding.

Day to day working capital is funded by an overdraft facility which is to be reviewed by the bank in June 2006. The company also has a bank loan which is due for repayment in January 2007. This loan has a debt covenant specifying that the company's debt to equity ratio should not exceed parity (ie 1:1).

Required

Identify from the information above, the key audit risks, and for each risk:

- | | | |
|------|---|------------------|
| (i) | list the factors that have led you to identify that risk; and | 25
(15 marks) |
| (ii) | outline the audit work you would perform in that risk area. | 15
(10 marks) |

Total: 25 marks

40

QUESTION ONE

Risk	Factor	Audit work
• Misstated opening balances • Failure to recognise events or transactions which are significant to the client	• New client/lack of familiarity	• Check opening balances brought forward • Consultation with management • Review of previous periods accounting records & control procedures • Consider whether the findings of current year indicate doubts about the opening balances
ATED • Understand income • Under-provision of VAT & corporation tax	• Cash transactions	• Identify and test controls over cash handling • Analytical review (levels of bookings, inter-business comparisons)
• Unrecognised liabilities	• Recent accidents	• Careful review of legal correspondence • Enquiry of legal advisors and management
• Misstated amounts in accounts	• Use of leasing which may be finance leases particularly as client is responsible for repairs	• Inspect lease agreement to ascertain which part has risk and rewards of ownership
• Incomplete disclosures in financial statements	• Polly Lunn has majority shareholding in a trading partner	• Ensure related part disclosures made in the notes to the accounts • Obtain written representations confirming completeness of disclosure
• Going concern	• Overdraft due for renewal • Lease obligations • Loan due to repayment • Debt covenant which may be breached if lease is finance lease	• Review forecasts to ensure company can pay its debts as they fall due

1 mark per risk and audit procedure
 ½ mark per factor

20 maximum, in region of 24 possible marks