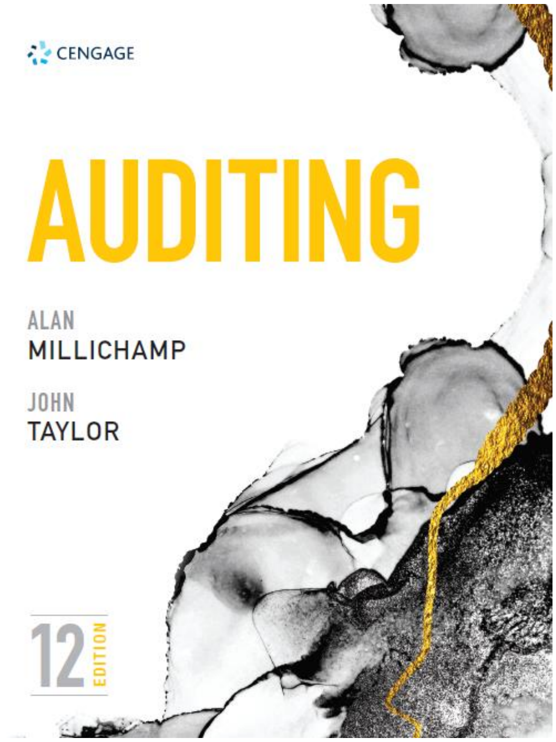

Case Studies – ANSWERS

Chapter 1
Introduction to Auditing – The Why of Auditing

Case Study 1

What benefits would the company get from employing an independent auditor?

Consider:

- Credibility of financial statements – particularly when borrowing money
- Financial statements correctly stated for taxation purposes
- Benefits when dealing with suppliers and employees – more reliable financial information creates increased confidence in reliability of company information
- Protection of minority shareholders
- Review of internal systems of control
- Increased likelihood of the prevention and detection of errors and fraud
- Improved risk management.

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Where would they find a suitable auditor?

The company is below the threshold for a statutory audit so would not need to appoint a registered auditor. Consequently a suitably qualified accountant would suffice, however it is good practice to appoint an appropriately qualified person – particularly if the company is expected to grow.

Both ACCA and ICAEW (in England, ICAS in Scotland and ICAE in Ireland) have registers of appropriately qualified auditors who could be approached.

Would it benefit Bertha to have a proper audit?

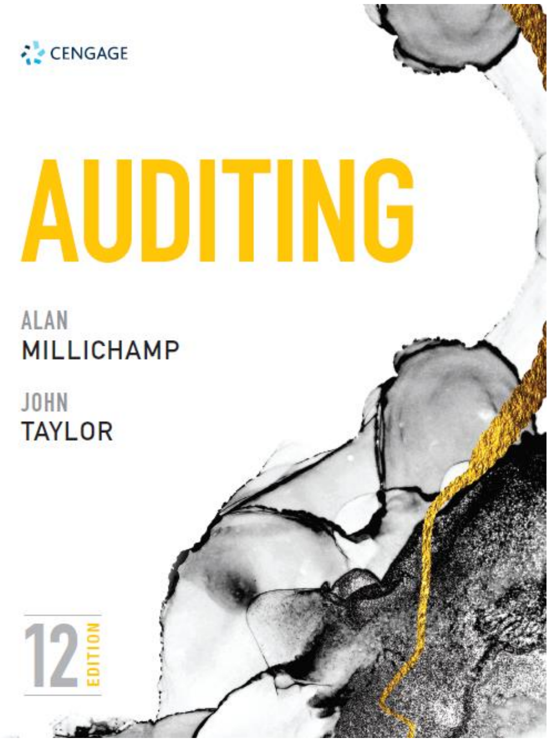
Consider:

- Principles of agency theory – actions of Gibbs & Angelo
- Protection of minority shareholders
- Safeguard company value
- Disclosure of directors' remuneration and benefits
- Points made above in regard to the appointment of a qualified auditor.

Case study 2

Questions are designed for open discussion. Key points might be:

- The purpose of audit is to ensure that the managers of a business are accounting properly to the owners of the business.
- The use of an independent financial intermediary in this way is an important support for financial institutions and markets.
- The ongoing debate about the auditors' responsibility for detecting fraud will continue – however good auditing practice should raise red flags in the case of major frauds.
- Auditing should not have a wider public interest function, otherwise where does it end? Auditors do not comment on management performance of strategy.
- The auditor's remit is to report on the financial results without fear or favour – if that reveals incompetence of fraud then so be it. Companies go down without any help from the audit.
- There is an argument that financial statements are too complex. In the search for perfection standard-setting bodies have created immense sets of complex rules. There is an argument for simplification and less technical language for the average investor or stakeholder.



Book Exam Questions – ANSWERS

Chapter 1
Introduction to Auditing –
The Why of Auditing

1 Growbig plc

(a) The key stakeholders in the company who are relevant to this issue principally comprise of:

- the shareholders – including minorities
- the directors
- the customers using the materials
- the members of the public coming into contact with the materials or consequences of it being used e.g. relative to toxic chemicals, pollutants, etc.
- the regulatory agencies/government bodies
- the employees – particularly overseas employees.

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(b) The company is in a particularly sensitive market and simply providing the minimum information is not enough. It should disclose the environmental impact of its products, information about its health and safety record, its policies on sales of products overseas, etc.

Environmental reporting would be a key issue as shareholders and the public expect a greater sense of corporate social responsibility from companies, particularly those where the ethics of their policies might be called into question.

Consider:

- the ethical position of the company with regard to overseas sales.
- the actual environmental impact of using banned products.
- the impact on the company in the case of health and safety breaches and accidents to employees – both financial and reputational.
- the reputational risk could damage home market sales with adverse publicity.

(c) Directors have a duty to protect the company's assets, and a wider duty to the public at large. They must review the dumping policy and consider what needs to be done to correct the situation in the hazardous factory.

They must investigate all allegations. This could involve the non-executive directors and the internal audit function as the investigation should be seen to be independent and thorough. The directors cannot ignore the revelations and must take steps to respond.

They should create clear policies and guidelines regarding overseas sales and the sale of banned materials and, if these constitute a hazard, they should stop production.