HOLMES
INSTITUTE
Cum Propris Suis Alis Volat

HI6026 Audit, Assurance and Compliance
TRIMESTER 2, 2017
INDIVIDUAL ASSIGNMENT 1

Assessment Value: 20%

Instructions:

- This assignment is to be submitted in accordance with assessment policy stated in the Subject Outline and Student Handbook.
- It is the responsibility of the student who is submitting the work, to ensure that the work is in fact her/his own work. Incorporating another's work or ideas into one's own work without appropriate acknowledgement is an academic offence. Students should submit all assignments for plagiarism checking on Blackboard before final submission in the subject. For further details, please refer to the Subject Outline and Student Handbook.
- Answer all questions.
- Maximum marks available: 20 marks.
- Due date of submission: Week 6, Friday at 5.00 p.m.

Case Study on Double Ink Printers Ltd (DIPL)

Background Information

You are a senior manager with Stewart and Kathy and you have been approached to undertake the audit of Double Ink Printers Ltd (DIPL). For the year ended 2015, taking over from the small audit firm of Jay and Associates. DIPL print books, magazines and advertising materials for the publishing, educational and advertising industries on a print-on-demand basis. Printing on demand means that publishers can print the exact quantities ordered by retail outlets, rather than estimating in advance how many books are required and often printing too few or too many. The average printing turnaround time for DIPL is two business days for small orders and five to ten business days for large orders. In addition, five years ago, DIPL further expanded its earnings base by having publisher's titles available as searchable 'e-books' that could be downloaded directly by readers from DIPL's website.

Purchase and Inventory

DIPL purchases 50% of its inventory requirements of paper, ink and binding materials from Australian sources and 50% from Asian countries. When inventory received at DIPL's warehouse (whether it is purchased from Australia or Asia), the accounts payable clerk, Bill Jimmy, records the arrival of the inventory and also its value and quantity in the accounts payable system. Inventory is paid for the relevant currency of the country from which it is purchased. Raw materials have been valued at average cost and an allowance for inventory obsolescence has existed in previous years to cover the estimated decline in value from the effects of storage hazards. Work in progress is immaterial due to the quick turn- around time of printing jobs. Any work in progress is assessed at the cost of raw materials and labour and proportion of manufacturing overheads based on normal capacity. At year end, the warehouse is closed from 28 to 30 June for stocktake, so sales must be invoiced in the system by close of business on 27 June. The stock must have been sent to the customer (that is, it must either be on track, ship or plane on its way to the customer, or it must already have arrived at the customer; it must no longer be in DIPL's warehouse).

‘Print on Demand’ revenue and receivables

Each time a publisher wants to add a book to DIPL’s ‘digital library’ (a server storing all of the publisher’s books in a digital format, ready to print), it emails the book to DIPL in PDF format. The digital library is backed up at the close of business every day, with the backup tapes kept off site. Once the book is stored in the digital library, the publishers can order copies to be printed as required.

When the publishers confirm the order, the accounting system automatically retrieves details of the publisher’s credit record and stops any orders from publishers that have exceeded their credit terms and limits. A printout of the transactions history of the publishers is generated and must be signed by both Helena keng, the head of publishing, and Jane Roger, the head of accounts at DIPL, before the order can continue, after the transaction history has been signed and dated, accounts receivable staff file it.

If there are no credit problems with the order, it is processed and printed by casual staff in the relevant warehouse, who then load the books onto pallets for shipping. When printing is finished, the sales clerk, Brown Pall, prepares an invoice and dispatch docket and forwards them to the accounts receivable department. The accounts receivable clerk Gay Chan, checks the prices and arithmetic accuracy of the invoices and signs the invoice as evidence of her check. Gay records the sales both the accounts receivables subsidiary ledger and the general ledger and books are shipped to the publisher’s nominated destination (or the publisher will arrange pick up at the warehouse if has its own distributors). The client accepts liability for the goods when they are received in accordance with the purchase order, and signs the dispatch docket as proof of delivery.

‘E-book’ Revenue

The proceeds from each e-book sale are paid to the publisher’s net of a 5% commission. Proceeds are sent to publishers automatically upon download (the commission is withheld by DIPL). Revenue from the commission is recognised when is withheld from payment to the publishers.

DIPL also charge publishers an annual “storage fee” payable 12 months in advance, for keeping the e-book on DIPL’s website. Publishers are invoiced on the date the first download of a title occurs. As new books are downloaded on an ongoing basis, the storage fee is invoiced at different times of the year. Revenue from storage fees has been recognised in the month the fees are invoiced, notwithstanding the fact that the fees are charged 12 months in advance.

In September 2014, DIPL acquired Nuclear Publishing Ltd (NPL). The main rationale behind the lay in the value of the copyright NPL held over a large range of specialised medical textbooks. Although the potential print run for the textbook was not large, each textbook had a high profit margin and had been used in universities across the world for many years. DIPL acquired the business operation of NPL (not the shares), paying net assets (including the right to the copyright). However, in June 2015 an article was published in a medical journal about a new theory that could result in NPL's medical textbooks becoming obsolete. If the new theory is valid, the textbooks are unlikely to be reprinted or used as textbooks at universities in the future, effectively making them unviable as e-books.

Cash Receipts

Some Payments from accounts receivables are received by cheque through the mail, and the cashier, Judy Bones, record these in an inwards remittance register when the mail is opened. She then banks the cheques and forwards the payment advices to Gay Chan for posting ton the accounts receivable ledger. Most payments, however, are received by electronic funds transfer (EFT). Each day, Judy downloaded the previous day's receipts from online banking and provides a copy to Gary for posting. Judy then reconciles the total of the batch postings to accounts receivable to the amount banked for the day. The assistant accountant, Boby Roger, prepares a bank reconciliation at the end of each month.

Fixed Assets

Since DIPL's incorporation, depreciation on assets has been calculated using the straight-line method to allocate their cost over their estimated useful lives, as follows:

- Printing presses up to 20 years
- Other production equipment up to 15 years
- Other equipment up to 10 years

Finance

During 2015, DIPL has entered into a 7.5 million loan from BDO Finance Ltd (BDO Finance). The loan has debt covenant's requiring DIPL to maintain a current ratio of at least 1.5 and a debt to equity ratio of less than 1. Failure to maintain these key financial ratios under the specified benchmarks would result in BDO Finance having the right to recall the loan.

Appointment of New CEO and internal Audit

William Jackson was appointed the new chief executive officer (CEO) of DIPL in January 2015. William has extensive experience in the printing business. The previous CEO, Rebecca Styles, who is now semi- retired, will remain on the board as a non-executive director. A component of William's remuneration package is a performance bonus based DIPL achieving an annual growth of 10% in total revenue and 10% in net profit after tax. Based on William's recommendation, the board also established a new internal audit department headed up by Cody Baines, an ex-audit manager with a Big Four audit firm and two other recently qualified chartered accountants. Cody reports directly to the board.

New IT System

During 2015, DIPL decided to invest in a new IT system that would fully computerised and integrate all the current accounting processes across the organisation, including integration into the general ledger system.

Under extreme pressure from the board, the IT department at DIPL managed to get the new accounting system installed in June, although IT manager, Andy Rogers, complained several times about how the installation was handled. Andy claimed that excess pressure had been placed on staff to get the system installed and that there was simply not enough staff to do the proper reconciliation's and testing before the new system went live prior to year-end.

Andy preliminary testing showed that some transactions conducted around year-end were not being allocated to the correct period. The problem appeared to be the interface between the new accounting system and one of the existing software systems. A software 'patch' had to be written to fix the problem.

Board year-end reporting discussions

As a board meeting held in June 2015, issues relating to the forthcoming year end were discussed. William stated that he believed that the valuation of raw materials inventories at average cost was no longer appropriate as the current cost of paper was substantially above the average cost. Further, he argued that the allowance for obsolescence of inventory to cover the estimated decline in value from the effects of storage hazards was necessary, as such a loss was unlikely. William also stated that based on his experience in the printing industry he believed that DIPL's printing presses had a potential maximum life of 30 years, although he noted that another leading entity in the printing industry adopted the policy of depreciating its printing presses over a 20-year period on a straight-line basis, similar to what DIPL had done in the past. After much discussion, the board resolved that the allowance for obsolescence of inventory be written back and that raw materials be valued based on a first-in, first-out (FIFO) basis. In addition, following a review of the e-book facilities by internal audit, Cody recommended that in a report to the board that DIPL change the method it used to account for its revenue from e-book publication to ensure compliance with the applicable accounting standard. The board agreed that the revenue from e-book would be recognised in accordance with the stage of completion of each transaction (i.e. percentage of completion method).

Statement of Financial Position

	Note	2013	2014	2015
				(Unadjusted)
Current Assets				
Cash		647250	517788	347120
Accounts Receivables	1	2482500	4320000	5073309
Inventories	2	2256188	2671362	4180500
Total		**5385938**	**7509150**	**9600929**
Non-Current Assets				
Property, Plant and Equipment	3	7544062	8394750	15572062
Intangible Assets		-------	-------	975000
		7544062	8394750	16547062
Total Assets		**12930000**	**15903900**	**26147991**
Current Liabilities				
Accounts Payable		1950000	3035250	3525000
Deferred revenue		----	----	697500
Interest-bearing liabilities		937500	862500	787500
Provisions		810000	1125000	1267500
Accruals		82500	97500	120000
Total		**3780000**	**5120250**	**6397500**
Non-current Liabilities				
Interest-bearing liabilities		----	----	7500000

Total Liabilities		3780000	5120250	13897500
Net Assets		**9150000**	**10783650**	**12250491**
Equity				
Shareholders Fund		2250000	2250000	2250000
Retained Profits		6900000	8533650	10000491
Total Equity		**9150000**	**10783650**	**12250491**

Income Statement

	2013	2014	2015
Revenues			
Revenue from Operations	34212000	37699500	43459500
Cost of Sales	28207500	31620000	36855000
Gross Profit	6004500	6079500	6604500
Allowance for inventory obsolescence written back	-------	-------	155588
Commission Income	108000	123000	130500
E-book storage fees	667500	1027500	1417500
Income from operating activities	**6780000**	**7230000**	**8308088**
Expenses			
Advertising	83725	115923	125778
Audit Fees	112500	127500	135000
Bad Debt	150000	195000	210000
Depreciation	249375	274312	472688
Discounts allowed	195000	285000	335500
Legal Fees	74000	111500	137000
Foreign Exchange loss	38500	49750	----
Rates	98500	106000	113500

Repairs and maintenance	224000	276500	306500
Salaries	1965000	2190000	2445000
Telecommunication costs	134750	141478	159785
Total expenses	**3325350**	**3872963**	**4440751**
Net income before interest and tax	3454650	3357037	3867337
Interest expense	84379	83663	808038
Profit before tax	3370271	3273374	3059299
Income tax	1011081	982012	87116
Profit after tax	**2359190**	**2291362**	**2972183**

Notes to the Financial Report

		2013	**2014**	**2015**
				(Unadjusted)
	Account Receivable	2647500	453000	5313309
1	Allowance for doubtful debts	-165000	-210000	-240000
		2482500	243000	5073309
	Inventory	**2362500**	**2797238**	**4180500**
2	Allowance for obsolescence	-106312	-125876	------
		2256188	**2671362**	**4180500**
3	**Property, Plant & Equipment**			
	Land	2775000	3375000	3375000
	Plant and Equipment	5250000	5775000	13425000
	Accumulated Depreciation	-480938	-755250	-1227938
		7544062	**8394750**	**15572062**

Required:

Question 1: As an auditor, you are conducting your preliminary analytical procedures based on the background information for DIPL contained in the case. Apply analytical procedures to the financial report information of DIPL for the last three years. Explain how your results influence your planning decisions for the audit for the year ending 30 June 2015 (10 marks).

Question 2: You are conducting your risk assessment of DIPL, as part of the planning for your audit for the year ended 30 June. Identify two inherent risk factors that arise from the nature of DIPL's business operations. Explain why it is a risk and how it may affect the risk of material misstatement in the financial report (5 marks).

Question 3: As part of your audit of DIPL for the year ended 30 June 2015, you are considering the risk that fraud may have occurred **(a)** Based on the background information for DIPL contained in the case, identify and explain two key fraud risk factors relating to misstatements arising from fraudulent financial reporting to which DIPL may be susceptible. **(b)** Explain how the risk factors identified in (a) above would affect the conduct of the (a) audit. (5 marks).