

Fundamentals Level – Skills Module

Audit and Assurance

Thursday 4 June 2015



Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

This paper is divided into two sections:

Section A – ALL 12 questions are compulsory and **MUST** be attempted

Section B – ALL SIX questions are compulsory and **MUST** be attempted

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

Do NOT record any of your answers on the exam paper.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

8
F
Paper

ACCA

Section B – ALL SIX questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

- 1** You are an audit senior of Beech & Co and have been allocated to the audit of Willow Wands Co (Willow), a listed company which has been an audit client for eight years and specialises in manufacturing musical instruments.

Bethan Oak was the audit engagement partner for Willow and as she had completed seven years as the audit engagement partner, she has recently been rotated off the audit engagement. The current audit partner, Sandeep Pine, has suggested that in order to maintain a close relationship with Willow, Bethan should undertake the role of independent review partner this year. In addition Willow has requested that Bethan assist them by attending their audit committee meetings, as a non-executive director has recently left the company.

Willow has also asked Sandeep and the other partners at Beech & Co to help them in recruiting a new non-executive director.

The total fees received by Beech & Co for last year equated to 16% of the firm's total fee income. The current year's audit fee has not yet been confirmed, but along with taxation and other possible non-audit fees the total income from Willow this year could be greater than for last year. Last year's audit fee was being paid monthly by Willow but no payments have been made for the last three months.

The audit manager for Willow has just announced that he is leaving Beech & Co to join Willow as the financial controller.

Required:

Using the information above:

- (i) **Identify and explain FIVE ethical threats which may affect the independence of Beech & Co's audit of Willow Wands Co; and**
(ii) **For each threat explain how it might be reduced to an acceptable level.**

Note: The total marks will be split equally between each part.

(10 marks)

- 2 (a) ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* describes the five components of an entity's internal control.

Required:

Identify and briefly explain the FIVE components of an entity's internal control. (5 marks)

- (b) Bonsai Trading Co (Bonsai) manufactures electrical equipment, and its year end is 30 September 2015. You are the audit supervisor of Poplar & Co and are developing the audit programmes for the forthcoming interim audit. The company's internal audit department has provided you with documentation relating to the non-current assets cycle including the related controls listed below.
- Bonsai has a capital expenditure committee and all purchase orders for capital items are required to be authorised by this committee.
 - On receipt, each asset is assigned a unique serial number and this is recorded on the asset and in the non-current assets register.
 - When the asset arrives, a goods received note (GRN) is completed which details the nature of the expenditure (i.e. whether it is capital or revenue), and the GRN classification is reviewed and initialled by a responsible official. Copies of the GRNs relating to capital expenditure are then submitted to the finance department for updating of the non-current assets register.
 - Periodically, internal audit undertakes a review of assets in the register and compares them to assets on site, using the serial number to confirm existence of the asset.
 - Access to the non-current assets register is restricted through passwords to a small number of staff in the finance department.

Required:

Describe a test of control which the auditor of Bonsai Trading Co would perform to assess whether or not each of the non-current asset controls listed above is operating effectively. (5 marks)

(10 marks)

3 You are the audit manager of Chestnut & Co and are reviewing the key issues identified in the files of two audit clients.

Palm Industries Co (Palm)

Palm's year end was 31 March 2015 and the draft financial statements show revenue of \$28.2 million, receivables of \$5.6 million and profit before tax of \$4.8 million. The fieldwork stage for this audit has been completed.

A customer of Palm owed an amount of \$350,000 at the year end. Testing of receivables in April highlighted that no amounts had been paid to Palm from this customer as they were disputing the quality of certain goods received from Palm. The finance director is confident the issue will be resolved and no allowance for receivables was made with regards to this balance.

Ash Trading Co (Ash)

Ash is a new client of Chestnut & Co, its year end was 31 January 2015 and the firm was only appointed auditors in February 2015, as the previous auditors were suddenly unable to undertake the audit. The fieldwork stage for this audit is currently ongoing.

The inventory count at Ash's warehouse was undertaken on 31 January 2015 and was overseen by the company's internal audit department. Neither Chestnut & Co nor the previous auditors attended the count. Detailed inventory records were maintained but it was not possible to undertake another full inventory count subsequent to the year end.

The draft financial statements show a profit before tax of \$2.4 million, revenue of \$10.1 million and inventory of \$510,000.

Required:

For each of the two issues:

- (i) Discuss the issue, including an assessment of whether it is material;**
- (ii) Recommend ONE procedure the audit team should undertake to try to resolve the issue; and**
- (iii) Describe the impact on the audit report if the issue remains UNRESOLVED.**

Notes:

- 1 The total marks will be split equally between each of the two issues.
- 2 Audit report extracts are NOT required.

(10 marks)

4 Cherry Blossom Co (Cherry) manufactures custom made furniture and its year end is 30 April. The company purchases its raw materials from a wide range of suppliers. Below is a description of Cherry's purchasing system.

When production supervisors require raw materials, they complete a requisition form and this is submitted to the purchase ordering department. Requisition forms do not require authorisation and no reference is made to the current inventory levels of the materials being requested. Staff in the purchase ordering department use the requisitions to raise sequentially numbered purchase orders based on the approved suppliers list, which was last updated 24 months ago. The purchasing director authorises the orders prior to these being sent to the suppliers.

When the goods are received, the warehouse department verifies the quantity to the suppliers despatch note and checks that the quality of the goods received are satisfactory. They complete a sequentially numbered goods received note (GRN) and send a copy of the GRN to the finance department.

Purchase invoices are sent directly to the purchase ledger clerk, who stores them in a manual file until the end of each week. He then inputs them into the purchase ledger using batch controls and gives each invoice a unique number based on the supplier code. The invoices are reviewed and authorised for payment by the finance director, but the actual payment is only made 60 days after the invoice is input into the system.

Required:

In respect of the purchasing system of Cherry Blossom Co:

- (i) Identify and explain FIVE deficiencies; and**
- (ii) Recommend a control to address each of these deficiencies.**

Note: The total marks will be split equally between each part.

(10 marks)

- 5** You are the audit supervisor of Maple & Co and are currently planning the audit of an existing client, Sycamore Science Co (Sycamore), whose year end was 30 April 2015. Sycamore is a pharmaceutical company, which manufactures and supplies a wide range of medical supplies. The draft financial statements show revenue of \$35.6 million and profit before tax of \$5.9 million.

Sycamore's previous finance director left the company in December 2014 after it was discovered that he had been claiming fraudulent expenses from the company for a significant period of time. A new finance director was appointed in January 2015 who was previously a financial controller of a bank, and she has expressed surprise that Maple & Co had not uncovered the fraud during last year's audit.

During the year Sycamore has spent \$1.8 million on developing several new products. These projects are at different stages of development and the draft financial statements show the full amount of \$1.8 million within intangible assets. In order to fund this development, \$2.0 million was borrowed from the bank and is due for repayment over a ten-year period. The bank has attached minimum profit targets as part of the loan covenants.

The new finance director has informed the audit partner that since the year end there has been an increased number of sales returns and that in the month of May over \$0.5 million of goods sold in April were returned.

Maple & Co attended the year-end inventory count at Sycamore's warehouse. The auditor present raised concerns that during the count there were movements of goods in and out the warehouse and this process did not seem well controlled.

During the year, a review of plant and equipment in the factory was undertaken and surplus plant was sold, resulting in a profit on disposal of \$210,000.

Required:

- (a) State Maples & Co's responsibilities in relation to the prevention and detection of fraud and error.** (4 marks)
- (b) Describe SIX audit risks, and explain the auditor's response to each risk, in planning the audit of Sycamore Science Co.** (12 marks)
- (c)** Sycamore's new finance director has read about review engagements and is interested in the possibility of Maple & Co undertaking these in the future. However, she is unsure how these engagements differ from an external audit and how much assurance would be gained from this type of engagement.

Required:

- (i) Explain the purpose of review engagements and how these differ from external audits; and** (2 marks)
- (ii) Describe the level of assurance provided by external audits and review engagements.** (2 marks)

(20 marks)

- 6 (a) (i) **Identify and explain FOUR financial statement assertions relevant to classes of transactions and events for the year under audit; and**
(ii) **For each identified assertion, describe a substantive procedure relevant to the audit of REVENUE.** (8 marks)

(b) Hawthorn Enterprises Co (Hawthorn) manufactures and distributes fashion clothing to retail stores. Its year end was 31 March 2015. You are the audit manager and the year-end audit is due to commence shortly. The following three matters have been brought to your attention.

(i) Supplier statement reconciliations

Hawthorn receives monthly statements from its main suppliers and although these have been retained, none have been reconciled to the payables ledger as at 31 March 2015. The engagement partner has asked the audit senior to recommend the procedures to be performed on supplier statements. (3 marks)

(ii) Bank reconciliation

During last year's audit of Hawthorn's bank and cash, significant cut off errors were discovered with a number of post year-end cheques being processed prior to the year end to reduce payables. The finance director has assured the audit engagement partner that this error has not occurred again this year and that the bank reconciliation has been carefully prepared. The audit engagement partner has asked that the bank reconciliation is comprehensively audited. (4 marks)

(iii) Receivables

Hawthorn's receivables ledger has increased considerably during the year, and the year-end balance is \$2.3 million compared to \$1.4 million last year. The finance director of Hawthorn has requested that a receivables circularisation is not carried out as a number of their customers complained last year about the inconvenience involved in responding. The engagement partner has agreed to this request, and tasked you with identifying alternative procedures to confirm the existence and valuation of receivables. (5 marks)

Required:

Describe substantive procedures you would perform to obtain sufficient and appropriate audit evidence in relation to the above three matters.

Note: The mark allocation is shown against each of the three matters above.

(20 marks)

End of Question Paper