

Professional Level – Options Module

Advanced Audit and Assurance (Irish)

September/December 2016 – Sample Questions



Time allowed 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Do NOT open this question paper until instructed by the supervisor.

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

Think Ahead

ACCA

The Association of
Chartered Certified
Accountants

Paper P7 (IRL)

Section A – BOTH questions are compulsory and MUST be attempted

- 1 The Zed Communications Group (ZCG) is an audit client of your firm, Tarantino & Co, with a financial year ending 31 December 2016. You are the manager assigned to the forthcoming audit. ZCG is an Irish listed entity, and is one of the largest telecommunications providers in Ireland and is also seeking to expand internationally. ZCG also provides broadband and fixed telephone line services.

You have just received the following email from the audit engagement partner:

To: Audit engagement manager
From: Vincent Vega, audit engagement partner
Subject: ZCG audit planning

Hello

We need to begin planning the final audit of ZCG, which as you know is one of our largest audit clients. I met with the Group's finance director yesterday and I have provided you with notes from this meeting along with extracts from the latest management accounts. We also discussed the possibility of using the work of the Group's internal audit team, as this should improve audit efficiency. I have provided you with an extract from the latest report of the internal audit department.

Using this information, you are required to prepare briefing notes for my use in which you evaluate the audit risks relevant to planning the final audit of ZCG.

You should also discuss the matters to be considered in determining the extent of assistance which can be provided by ZCG's internal audit department.

Finally, your briefing notes should recommend the principal audit procedures to be performed on the classification of the 50% equity shareholding in WTC as a joint venture, and the measurement of the intangible asset recognised in respect of the licence to operate in Farland.

Thank you.

Notes from meeting with finance director

One of ZCG's strategic aims is to expand internationally, either by acquiring existing telecommunications providers in foreign countries, or by purchasing licences to operate in other countries.

In March 2016, ZCG purchased a 50% equity shareholding in Wallace Tele Coms Ltd (WTC), a company operating in several countries where ZCG previously had no interests. The other 50% is held by Wolf Communications Ltd. The cost of the 50% equity shareholding was €45 million. ZCG is planning to account for its investment in WTC as a joint venture in the Group financial statements.

On 1 January 2015, ZCG purchased a licence to operate in Farland, a rapidly expanding economy, at a cost of €65 million. The licence lasts for 10 years from the date that it was purchased. Since purchasing the licence, ZCG has established its network coverage in Farland and the network became operational on 1 July 2016. The licence was recognised as an intangible asset at cost in the Group statement of financial position at 31 December 2015. Since the network became operational, customer demand has been less than anticipated due to a competitor offering a special deal to its existing customers to encourage them not to change providers.

Most of ZCG's mobile phone customers sign a contract under which they pay a fixed amount each month to use ZCG's mobile network, paying extra if they exceed the agreed data usage and airtime limits. The contract also allows connection to a fixed landline and internet access using broadband connection and most contracts run for two or three years. For the first time this year, the Group is adopting IFRS 15 *Revenue from Contracts with Customers*.

In order to extend its broadband services, ZCG has started to purchase network capacity from third party companies. ZCG enters a fixed-term contract to use a specified amount of the seller's network capacity, with the seller determining which of its network assets are used by ZCG in supplying network services to its customers. In the first six months of 2016, ZCG purchased €17.8 million of network capacity from a range of suppliers, with the contract periods varying from twelve months to three years. The cost has been capitalised as an intangible asset.

Internal audit

ZCG has a well-established internal audit department which is tasked with a range of activities including providing assurance to management over internal controls and assisting the Group's risk management team. The internal audit department is managed by Jules Winfield, a qualified accountant with many years' experience. An extract from the executive summary of the latest internal audit report to the Group finance director is shown below:

'We are pleased to report that ZCG's internal controls are working well and there have been no significant changes to systems and controls during the year. As a result of our testing of controls we uncovered only two financial irregularities which related to:

- Failure to obtain appropriate authorisation and approval of senior management expense claims, such as travel and other reimbursements; the unsubstantiated expense claims amounted to €575,000.
- Inadequate access controls over the Group's IT systems; this resulted in a payroll fraud amounting to €750,000.'

Financial information – extracts from latest management accounts

	8 months to 31 August 2016 € million	Audited financial statements to 31 December 2015 € million
Revenue:		
Europe	106	102
Americas	30	68
South East Asia	33	30
India	29	20
Total	<u>198</u>	<u>220</u>

	At 31 August 2016 € million	At 31 December 2015 € million
Total assets	598	565

Required:

Respond to the instructions in the audit engagement partner's email.

(31 marks)

Professional marks will be awarded for the presentation of the briefing notes and the clarity of the explanations provided.

(4 marks)

(35 marks)

2 You are the manager responsible for the audit of Thurman Ltd, a manufacturing company which supplies stainless steel components to a wide range of industries. The company's financial year ended on 31 July 2016 and you are reviewing the audit work which has been completed on a number of material balances and transactions: assets held for sale, capital expenditure and payroll expenses. A summary of the work which has been performed is given below and in each case the description of the audit work indicates the full extent of the audit procedures carried out by the audit team.

(a) Assets held for sale

Due to the planned disposal of one of Thurman Ltd's factory sites, the property and associated assets have been classified as held for sale in the financial statements. A manual journal has been posted by the finance director to reclassify the assets as current assets and to adjust the value of the assets for impairment and reversal of depreciation charged from the date at which the assets met the criteria to be classified as held for sale. The finance director asked the audit senior to check the journal before it was posted on the basis of there being no one with the relevant knowledge to do this at Thurman Ltd.

The planned disposal was discussed with management. A brief note has been put into the audit working papers stating that in management's opinion the accounting treatment to classify the factory as held for sale is correct. The manual journal has been arithmetically checked by a different member of the audit team and the amounts agreed back to the non-current asset register. (9 marks)

(b) Capital expenditure

When auditing the company's capital expenditure, the audit team selected a material transaction to test and found that key internal controls over capital expenditure were not operating effectively. Authorisation had not been obtained for an order placed for several vehicles, and appropriate segregation of duties over initiating and processing the transaction was not maintained.

The audit team noted details of the internal control deficiencies and updated the systems notes on the permanent audit file to reflect the deficiencies. The audit work completed on this order was to agree the purchase of the vehicles to purchase invoices and to the cash book and bank statement. The rest of the audit work on capital expenditure was completed in accordance with the audit programme. (7 marks)

(c) Payroll expenses

The payroll function is outsourced to Jackson Ltd, a service organisation which processes all of Thurman Ltd's salary expenses. The payroll expenses recognised in the financial statements have been traced back to year-end reports issued by Jackson Ltd. The audit team has had no direct contact with Jackson Ltd as the year-end reports were sent to Thurman Ltd's finance director who then passed them to the audit team.

Thurman Ltd employs a few casual workers who are paid in cash at the end of each month and are not entered into the payroll system. The audit team has agreed the cash payment made back to the petty cash records and the amounts involved are considered immaterial. (9 marks)

Required:

In respect of each of the three matters described above:

- (i) Comment on the sufficiency and appropriateness of the audit evidence obtained;**
- (ii) Recommend further audit procedures to be performed by the audit team; and**
- (iii) Explain the matters which should be included in a report in accordance with ISA 265 (UK and Ireland) *Communicating deficiencies in internal controls to those charged with governance and management.***

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

(25 marks)

Section B – TWO questions ONLY to be attempted

3 You are the manager responsible for the audit of Rope Ltd for the year ended 30 September 2016. During a visit to the team performing the fieldwork, the audit senior shows you a cash flow forecast covering six-month periods to 30 September 2018 as prepared by management as part of their assessment of the going concern status of the company. The audit senior asks whether any of the forecast cash flows disclosed require any further investigation during the audit fieldwork.

The actual and forecast six-monthly cash flows for Rope Ltd for the periods ended:

	Actual		Forecast			
	31 March 2016 €000	30 Sept 2016 €000	31 March 2017 €000	30 Sept 2017 €000	31 March 2018 €000	30 Sept 2018 €000
Operating cash flows						
Receipts from customers	13,935	14,050	14,300	14,700	14,950	15,400
Payments to suppliers	(10,725)	(10,850)	(11,050)	(11,400)	(11,600)	(12,000)
Salaries	(1,250)	(1,300)	(1,275)	(1,326)	(1,301)	(1,353)
Other operating cash payments	(1,875)	(1,850)	(1,913)	(1,887)	(1,951)	(1,925)
Other cash flows						
Sale of investments	–	–	–	–	–	500
Repayment of J Stewart loan	–	–	–	–	–	(500)
Repayment of bank loan	–	–	–	–	(1,500)	–
Receipt of bank loan	–	–	–	–	1,500	–
Cash flow for the period	85	50	62	87	98	122
Opening cash	(275)	(190)	(140)	(78)	9	107
Closing cash	(190)	(140)	(78)	9	107	229

The following additional information has been provided in support of the forecasts:

- Receipts from customers and payments to suppliers have been estimated based on detailed sales forecasts prepared by the sales director.
- Salaries and overheads have been estimated as the prior year cost plus general inflation of 2%.
- The bank loan expires on 5 January 2018. The finance director expects to take out a matching facility with the current lender to pay off the existing debt.
- On 1 October 2015, the chief executive, Mr J Stewart, gave the company a three-year, interest free loan secured by a fixed charge over the operational assets of Rope Ltd. The audit team was unaware of this loan prior to obtaining the cash flow forecast.
- The directors plan to sell some investments in listed shares to fund the repayment of the chief executive’s loan. At 30 September 2016, the investments were carried in the statement of financial position at their fair value of €350,000.

Required:

- (a) Evaluate the appropriateness of the cash flow forecast prepared by Rope Ltd and recommend the further audit procedures which should be performed.** (14 marks)
- (b) Comment on the matters to be considered in respect of the loan from Mr J Stewart and recommend the further audit procedures to be performed.** (6 marks)

(20 marks)

- 4 You are an audit manager at Thornhill & Co responsible for the audit of Northwest Ltd, a subsidiary of Valerian Ltd. A different audit firm is responsible for the audit of Valerian Ltd and the Valerian Group financial statements.

The audit of the financial statements of Northwest Ltd for the year ended 31 July 2016 is nearing completion, but the following issues require your attention before the auditor's report is signed and your final communication is made to the group auditor in response to their request for information. The draft financial statements of Northwest Ltd recognise a loss before tax of €50,000.

Northwest Ltd has been loss making for several years and it generates insufficient cash to meet its significant debt obligations. The company relies on support from Valerian Ltd in order to continue trading. The management of Valerian Ltd has confirmed verbally that it will continue to support Northwest Ltd, but has not provided a formal letter of support despite a number of requests.

Valerian Ltd is the subject of a major lawsuit following an industrial accident which led to significant pollution of local agricultural land and, most seriously, loss of life. You attempted to discuss the matter with the directors of Valerian Ltd but they refused, saying that it had already been investigated by the group auditor. The group auditor informed you that the case is ongoing and that they have obtained satisfactory representations from both management and legal advisers stating that they were confident of successfully defending the claim. When you asked for copies of the representations, the group auditor refused, saying it was a matter relevant to the parent company and that it was not relevant to the audit of Northwest Ltd.

Shortly after making your enquiries, you received a phone call from the group engagement partner who said that the board of Valerian Ltd was concerned that you might modify the auditor's report of Northwest Ltd. He also said that, as the only person with full oversight of audit matters relating to the Valerian Group, he did not think that it would be necessary to modify the auditor's report of Northwest Ltd and that he would oppose any attempt to do so. He suggested that if the debt in the financial statements of Northwest Ltd was the reason for seeking parental support that he would transfer it to the Group and the letter of support would no longer be necessary.

Required:

- (a) **Discuss how professional scepticism should be applied to the statements made by the management and auditors of Valerian Ltd regarding the outstanding legal case.** (6 marks)
- (b) **Comment on the ethical and professional issues raised, considering any implications for the completion of the audit, in respect of:**
- (i) **The evidence obtained in relation to the support offered by Valerian Ltd.**
 - (ii) **The request not to modify the auditor's report of Northwest Ltd.**

Note: The total marks will be split equally between each part. (14 marks)

(20 marks)

5 You are an audit manager working for Raven & Co, a firm of Chartered Certified Accountants. You specialise in the audits of companies in the information technology industry. Issues have recently arisen in relation to two different clients which require your attention.

- (a) Gull plc is a large company which is currently not listed and the majority of shares are owned by the Brenner family. Following the completion of the audit this year, the finance director, Jim Brenner, contacted you and told you that the family is now hoping to list the company on the Irish stock exchange. They would like to recruit one of your audit partners for a six-month period to help prepare for the listing. As the board is concerned that the necessary skills and personnel to support the listing are not currently present within the company, Jim Brenner has also requested that your firm assist them in identifying and recruiting new members to the board.

Most of the executive director roles are performed by family members, except for the directors of operations and human resources, who are both long-serving employees. The board operates no audit committee and there is only one non-executive director, who works elsewhere as an IT consultant. Other than the recruitment of new board members, Gull plc is not planning on making any changes to its governance structure prior to or subsequent to listing.

Gull plc has a financial year ending 31 March 2017, and audit planning is scheduled to take place in January 2017.

Required:

In relation to the information provided for Gull plc, comment on:

- (i) **The ethical and professional matters in relation to the recruitment requests made by Gull plc;**
- (ii) **The implications the governance structure and proposed listing may have on the audit process.**

Note: The total marks will be split equally between each part. (10 marks)

- (b) The audit of Crow Ltd, a designer and manufacturer of mobile information technologies, for the year ended 30 June 2016 is nearly complete and the auditor's report is to be signed imminently. The following outstanding matters still require your consideration. The draft reported profit before tax and total assets for the year are €65 million (2015 – €111 million) and €650 million (2015 – €910 million) respectively.

Military research project

During the year expenses totalling €7 million, relating to a new military research project, were recorded in the statement of profit or loss. The audit team was given brief summaries of the costs incurred but when asked for further corroborating evidence, management stated that they had signed a confidentiality agreement with the military and were unable to provide any further details. The only additional information provided was that they anticipated the project to last for three years and that it may lead to a highly lucrative contract.

Fire

During the year a major catastrophe took place when a fire caused significant damage to the operations of the company, leading to production ceasing for several months. While operations have resumed, repairs are ongoing and it is anticipated that full production will not resume for at least another six months. Audit procedures revealed that the matter has been fully and satisfactorily reflected and disclosed in the financial statements and that it does not pose a significant risk to the going concern status of Crow Ltd.

Required:

In respect of each of the matters described above, discuss the implications for the auditor's report and recommend any further actions necessary. (10 marks)

(20 marks)

End of Question Paper