Advanced Audit & Assurance (INT)

Sample Exam – December 2021

Get to know your exam

These graphical representations are intended to give an indication of exam requirements and associated question content.

Please note that you will not be able to complete answers within these documents and in isolation they will not sufficiently prepare you for your exam.

We encourage you to visit the ACCA Practice Platform in order to attempt up to date practice exams within the computer-based exam environment.

Instruction screens

AAA-INT September/December 2021 exam (21/22 syllabus)

Instructions (1 of 4)

The instructions displayed below are representative of those displayed in the live exam. Where there are differences between this past content exam and the live exam these are explained.

General Instructions

- In this exam, the instruction screens are not timed however in the live exam they will be available for a maximum of 10 minutes prior to the exam starting.
- In the live exam, the stated exam time will automatically start once the 10 minute period has passed (or earlier if you choose to start the exam within the 10 minute period).
- A copy of the instruction screens can be accessed at any time during the exam by selecting the Help button provided.

The Workspace

- Your exam consists of a number of questions. Each question is presented in a workspace. Each workspace will include:
    - Introductory information for the question.
    - Exhibits – these contain the question scenario content broken down into sections or sources of information you will need to answer the question requirement(s).
    - Requirements – these list the requirement(s) you are expected to answer in the workspace.
    - Response Options – you may be presented with one or more word processor and/or spreadsheet response options within which to construct your answer.
- When selected, the exhibits, requirements and response options will display in windows, which can be moved and resized as required.
- You can close each window individually or close all windows at once by selecting **Close All** on the top toolbar. This minimises the open windows to the left-hand side of the screen. Note that any answers you have entered into the response options will be saved and you can re-open them and change your answers at any time.
- There is a splitter bar which you can move to see more or less of the left or right hand side of the screen as required.
- You can highlight or strikethrough text in the introductory information, PDF exhibits or requirements by selecting **Highlight** or **Strikethrough**.
- You can copy and paste between exhibits, requirements and response options by using the Ctrl-C (Copy) and Ctrl-V (Paste) shortcuts.

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Instruction screens (continued)

AAA-INT September/December 2021 exam (21/22 syllabus)

Instructions (2 of 4)

Navigation

- The question number you are viewing is displayed in the top display bar. You can hide or restore this display by selecting .
- You can navigate between screens by selecting **Next** or **Previous** or by clicking on a question number from the Navigator or Item Review screens.
- You can revisit questions and change your answers at any time during the exam.

Flag for Review

- If you wish to revisit/review a question later in the exam, click **Flag for Review**.
- Click the button again to remove the flag.

Help

- Click the **Help** button provided to access:

- A copy of these exam instructions.
- Help and guidance on workspaces.
- Formulae sheets/tax tables if your exam requires these. Note that the name of the Help button will indicate if formulae sheets/tax tables are available i.e. **Help**, **Help/Formulae Sheet** or **Help/Tax Tables**

Calculator

- You have the option to use the on-screen standard or scientific calculators by selecting **Calculator**.
- Note that in the live exam you are also permitted to use your own calculator providing it does not have the facility to store or display text.

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Instruction screens (continued)

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Instructions (3 of 4)

Workings/Scratch Pad

- You may use an on-screen Scratch Pad to make notes/workings by selecting **Scratch Pad**
- You can cut and copy text from the Scratch Pad and paste into your response options either by using the Ctrl-C (Copy), Ctrl-X (Cut) and Ctrl-V (Paste) shortcuts, or the on-screen buttons.
- The Scratch Pad retains all notes/workings entered for all workspaces and these are available for the duration of the exam. They will not be submitted for marking after your live exam.
- You will also be provided with paper for notes/workings for your live exam, should you prefer to use it. This will not be submitted for marking. It will be collected at the end of the exam and must not be removed from the exam room.
- **Important:**
  - The notes/workings entered onto the Scratch Pad or your workings paper during the live exam will not be marked.
  - If you want the marker to see any notes/workings for question requirements in the live exam you must show them within the relevant response options.

Symbol

- You can add a selection of currency symbols to your answers by selecting **$ Symbol** on the top toolbar.

Navigator Screen

- Navigator can be accessed at any time during the exam by selecting **Navigator**.
- This screen allows you to jump to any question number in the exam.
- It also allows you to see the status of each question and whether it has been viewed, attempted or flagged for review.

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Instruction screens (continued)

AAA-INT September/December 2021 exam (21/22 syllabus)

Instructions (4 of 4)

Reviewing the Exam

- You can review this exam once you have attempted any, or all, of the questions.
- To do this:
  - Navigate to the **last question** in the exam.
  - Click **Next** .
- This takes you to the Item Review screen.

Item Review Screen

- This screen gives you a final opportunity to see the flag and attempted status of each question and to review your answers before you exit the exam.
- You can select individual questions you wish to revisit, or quickly access groups of questions from the Item Review screen.
- During the item review period Navigator is not available however you can navigate to questions by selecting **Next** , **Previous** or **Review Screen** .
- When reviewing questions you can change your answers and click **Review Screen** to view any updated status on the Item Review screen.

Ending the Exam

- Once you have completed your item review and wish to finally end the exam click **End Exam** from the Item Review Screen.
- Once you end the exam, you cannot revisit any questions. Your answers will then be available for marking and review.

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Exam summary screen

AAA-INT September/December 2021 exam (21/22 syllabus)

Exam Summary

Time allowed: This exam is not timed.

This exam is divided into two sections:

Section A

- One question worth 50 marks.
- 50 marks in total.

Section B

- Two questions, each worth 25 marks.
- 50 marks in total.

All questions are compulsory.

Select **Next** to start your exam.

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Exam questions

Section A – summary screen

AAA-INT September/December 2021 exam (21/22 syllabus)

Flag for Review

Section A

This section of the exam contains **one question**.

This question is worth **50 marks** and is compulsory.

This exam section is worth **50 marks** in total.

Important:

In your live exam, you should:

- Indicate which requirement each of your responses relate to so that this is clear for markers.
- Show all notes/workings that you want the marker to see within your responses. Remember, any notes/workings made on the Scratch Pad or on your workings paper will not be marked.

Select **Next** to continue.

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Section A – question 1

AAA-INT September/December 2021 exam (21/22 syllabus)

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$ Symbol ▼ Highlight Strikethrough Calculator Scratch Pad Close All Flag for Review

Exhibits

- 1. Partner's email
- 2. Business and governance
- 3. Financial information
- 4. Business developments
- 5. Meeting notes

Requirement

- Requirement (50 marks)

Response Options

- Briefing notes
- Spreadsheet

It is 1 July 20X5. You are a manager in the audit department of McClane & Co, a firm of Chartered Certified Accountants. You are assigned to the audit of Gruber Co, which has a financial year ending 30 September 20X5.

Gruber Co is a new audit client of McClane & Co, the audit firm having been appointed in January 20X5. The audit was previously performed by Ellis Associates.

Gruber Co is owned and managed by the Gruber family, its principal operations being the design and construction of bespoke machinery used in the oil industry.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Partner's email – an email which you have received from Al Powell, the audit engagement partner.
2. Business and governance – information and matters relevant to audit planning.
3. Financial information – extracts from Gruber Co's most recent management accounts.
4. Business developments – information relating to an investment property and customer contracts.
5. Meeting notes – extracts from meeting notes taken at a recent meeting with the board of directors of Gruber Co.

This information should be used to answer the question **requirement** within your chosen **response option(s)**.

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Requirements

Requirement (50 marks)

Respond to the instructions in the email from the audit engagement partner.

Note: The split of the mark allocation is shown in Exhibit 1 - Partner's email.

(46 marks)

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

(4 marks)

Exhibit 1

1. Partner's email

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To: Audit manager
From: Al Powell, Audit engagement partner
Subject: Audit planning for Gruber Co
Date: 1 July 20X5

Hello

I have provided you with some information which you should use to help you with planning the audit of Gruber Co for the financial year ending 30 September 20X5. As you know, Gruber Co is a new client and the firm's client due diligence (know your client) and acceptance procedures were all successfully completed.

I require you to prepare briefing notes for my own use in which you:

(a) Discuss the matters specific to the planning of an initial audit engagement which should be considered in developing the audit strategy for Gruber Co.

Note: As above, you do NOT need to discuss matters relating to whether it was appropriate for McClane & Co to accept Gruber Co as an audit client, as the acceptance is confirmed.

(6 marks)

(b) Using the information in **Exhibits 1, 2, 3 and 4**, evaluate the significant audit risks to be considered in planning the company audit.

(24 marks)

(c) Design the principal audit procedures to be performed in respect of the Nakatomi building, including those relating to the use of an expert to provide the fair value.

(8 marks)

Using the information in Exhibit 5:

(d) Discuss the ethical issues raised and recommend actions to be taken by our firm.

(8 marks)

Thank you.

Exhibit 2

2. Business and governance

The company was established 15 years ago by Martin Gruber, an engineer who had patented a new type of machine used in the oil industry. Martin, who is the company's chief executive officer, owns 60% of the shares in the company, with the remainder split equally between his brother and sister, Craig and Iris Gruber.

The company's board of directors includes Craig Gruber as chief finance officer (CFO), Iris Gruber as marketing director, and a non-family member, Kali Hayes, who is director of operations. Gruber Co has 300 employees, most of whom are mechanical engineers.

Martin is planning to sell his shares and retire from the business. Craig and Iris, who are younger than Martin, will retain their shares and their board positions. Initial discussion with a potential acquirer for Martin's shares began last month.

The company owns a head office and leases a production facility where machines are designed and assembled under contract with individual customers. Typically, an order takes 14 months to complete, from the initial design through to installation at the customer's premises. This is due to the large size of the machinery being produced to customer order and the very specific requirements of customers.

Exhibit 3

3. Financial information

Key information extracted from the management accounts

	Notes	Projected to 30 September 20X5 $ million	Actual to 30 September 20X4 $ million
Revenue	1	75	65
Operating profit	2	18	10
Profit before tax	3	**14**	**9**
Total assets		**120**	**88**
Included in total assets:			
Intangible assets	4	19	10

Note 1 Revenue is derived from contracts involving the design, manufacture and installation of machinery to customer order. Currently, the company establishes all of its customer contracts to contain only one performance obligation – the successful installation of the machine at the customer's premises.

However, around a quarter of the contracts also include a three-year support service for the machinery installed.

Note 2 Operating profit includes a profit of $2·2 million relating to the Argyle contract, details of which are given in Exhibit 4. This is the full amount of profit estimated to be made on the contract. The company's CFO suggests that while the company's accounting policy is to use the output method to determine the completion stage of a contract at the year end, it is appropriate to recognise the full amount of profit on this contract because the customer has paid in advance.

Operating profit also includes a loss of $700,000 relating to the Johnson contract, details of which are given in Exhibit 4. The loss is determined based on the estimated loss of $840,000 pro-rata over the number of months completed on the contract by 30 September 20X5.

Note 3 Profit before tax includes an estimated increase in the fair value of the Nakatomi building investment property of $2 million. Details are provided about this investment in Exhibit 4.

Note 4 The change in value of intangible assets represents a transaction which took place in March 20X5, whereby Gruber Co purchased some designs from Martin Gruber for $9 million. The value of this transaction was determined by Martin Gruber. The audit engagement partner has asked for information to support this value, but nothing has yet been received from Martin.

Exhibit 4

4. Business developments

Argyle contract

In October 20X4, Gruber Co entered into a significant contract to design, construct and install a large piece of machinery for a new customer, Argyle Co. In October 20X4, it was estimated that the design and construction of the machine would take 15 months, with installation estimated to take place in January 20X6. The agreed price of the machine is $6 million and Gruber Co will have incurred costs of $2·6 million in relation to this contract by 30 September 20X5. Based on the project plans, the estimated value of the work certified at 30 September 20X5 is $4 million and the estimated cost to complete is $1·2 million. As noted in Exhibit 3, operating profit includes a profit of $2·2 million relating to the Argyle contract.

Johnson contract

On 1 December 20X4, Gruber Co entered into a contract with Johnson Co, to design, construct and install a machine. The contract, which will take 12 months to complete, was initially projected to make a profit of $2·8 million. However, due to cost inflation and errors made in the initial project budget, the contract is now estimated to make a loss of $840,000.

Investment property

In October 20X4, following the completion of a significant contract, the company purchased an investment property, the Nakatomi building, for $15 million. The property is a retail development in the country's capital city. The company is going to appoint an expert to provide a valuation of the property and an initial estimate of the increase in fair value of $2 million has been included in the company's financial projections to 30 September 20X5.

Exhibit 5

5. Meeting notes

A meeting took place yesterday in which the audit engagement partner discussed the potential sale of Martin Gruber's shares with the company directors.

The company directors revealed that Willis Co is the company with whom negotiations have started in relation to the sale of Martin Gruber's shares. Willis Co is an existing audit client of McClane & Co.

The directors have requested that McClane & Co assist them with the sale by performing a vendor's due diligence service, in which they would conduct an independent review of Gruber Co's financial position and future prospects and produce a report on their findings to be provided to Willis Co.

Section B – summary screen

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Flag for Review

Section B

This section of the exam contains **two questions.**
Each question is worth **25 marks** and is compulsory.
This exam section is worth **50 marks** in total.

Important:

In your live exam, you should:

- Indicate which requirement each of your responses relate to so that this is clear for markers.
- Show all notes/workings that you want the marker to see within your responses. Remember, any notes/workings made on the Scratch Pad or on your workings paper will not be marked.

Select **Next** to continue.

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Section B – question 1

AAA-INT September/December 2021 exam (21/22 syllabus)

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Exhibits

- 1. Flynn Co
- 2. Cash flow forecast

Requirements

- Requirement a (10 marks)
- Requirement b (15 marks)

Response Options

- Word Processor
- Spreadsheet

It is 1 July 20X5. You are a manager in Kelly & Co, a firm of Chartered Certified Accountants which offers a range of assurance services.

The managing director of Flynn Co, which is not currently a client of Kelly & Co, has contacted you regarding a review engagement which he would like your firm to provide. Kelly & Co has already conducted specific client identification procedures in line with money laundering regulations with satisfactory results.

Flynn Co operates in the food processing industry, and the company is planning to build a new food processing facility in a foreign country. This will cost approximately $15 million to build, and Flynn Co has approached its lenders to provide the necessary finance.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Flynn Co – information regarding Flynn Co and the review engagement your firm is invited to provide.
2. Cash flow forecast – a cash flow forecast and supporting notes and assumptions to be used in support of a loan application.

This information should be used to answer the question **requirements** within your chosen **response option(s)**.

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Requirement a

Requirement a (10 marks)

Using the information in Exhibit 1 - Flynn Co:

(a) Evaluate the matters to be considered by Kelly & Co in deciding whether to accept Flynn Co as a client of the firm and whether to perform the review engagement to report on the business plan.

Note: You do NOT need to include matters relating specifically to client due diligence (Know Your Client) procedures.

(10 marks)

Requirement b

Requirement b (15 marks)

Using the information in Exhibit 2 and assuming that Kelly & Co accepts the engagement to review Flynn Co's cash flow forecast:

(b)(i) Evaluate the assumptions used by management and the completeness of the cash flow forecast prepared, explaining why particular assumptions should be challenged and approached with professional scepticism; and

(6 marks)

(b)(ii) Design the examination procedures which should be performed in the review of Flynn Co's cash flow forecast.

(9 marks)

Exhibit 1

1. Flynn Co

Flynn Co is an unlisted company whose main activity involves processing frozen food. The company has several processing plants in its home country and one located in a foreign country, Nearland. In order to expand its product range, the company is planning to build a new facility and begin processing in another foreign country, Farland. Flynn Co has approached its provider of finance, Mortons Bank, to provide a $15 million loan which will cover the necessary capital expenditure. Nearland and Farland both have a different currency than that used by Flynn Co.

Mortons Bank has asked Flynn Co to provide a business plan for the next three years in support of the loan application. The business plan includes forecast statements of profit or loss and cash flow. The bank has requested that the forecasts be subject to an independent review and that a review report should be included with the loan application.

Flynn Co is expecting to submit the business plan and review report to the bank on 5 August 20X5.

Flynn Co is audited by Roxie Associates. A new audit manager, Mary Sunshine, has recently been recruited to your firm from Flynn Co where she worked in the internal audit department, and she told you the following:

'I know that Flynn Co's auditor, Roxie Associates, has performed review engagements for the company in the past. I am aware that the latest external auditor's report, for the year ended 31 March 20X5, included a Material Uncertainty Related to Going Concern section due to the company's liquidity problems.'

In his communication with Kelly & Co, the managing director of Flynn Co has suggested that should Kelly & Co provide the report to the bank, and assuming that the finance is provided to the company, he will be willing to remove Roxie Associates as the company's auditor and appoint Kelly & Co to provide the audit service. The managing director has also requested that Mary Sunshine is part of the review team and the audit team, given her past experience with the company.

Exhibit 2

2. Cash flow forecast

Cash Flow Forecast for the three years to 30 June 20X8

	Note	Six month periods to: 31 December 20X5 $'000	30 June 20X6 $'000	31 December 20X6 $'000	30 June 20X7 $'000	31 December 20X7 $'000	30 June 20X8 $'000
Average monthly sales	1	200	234	265	288	308	318
Revenue		1,200.00	1,404.00	1,589.33	1,727.60	1,846.80	1,909.60
Cash inflow from customers	2	1,050.00	1,201.00	1,399.50	1,578.00	1,723.50	1,836.00
Operating expenses	3	(920.00)	(940.00)	(1,080.00)	(1,150.00)	(1,280.00)	(1,340.00)
Marketing for new product ranges		-	(100.00)	-	-	-	-
Interest payments and other finance costs		(30.00)	(30.00)	(30.00)	(30.00)	(30.00)	(30.00)
Dividends		(100.00)	-	(100.00)	-	(100.00)	-
Loan receipt		15,000.00	-	-	-	-	-
Capital expenditure	4	(7,500.00)	(7,500.00)	-	-	-	-
Net cash flow		**7,500.00**	**(7,369.00)**	**189.50**	**398.00**	**313.50**	**466.00**
Opening cash		50.00	7,550.00	181.00	370.50	768.50	1,082.00
Closing cash		**7,550.00**	**181.00**	**370.50**	**768.50**	**1,082.00**	**1,548.00**

Notes and key assumptions:

1 Monthly sales are based on management's forecasts with predicted sales growth as follows:

Six months to 31 December 20X5	0%
Six months to 30 June 20X6	17.00%
Six months to 31 December 20X6	13.20%
Six months to 30 June 20X7	8.70%
Six months to 31 December 20X7	6.90%
Six months to 30 June 20X8	3.40%

Exhibit 2 (continued)

2. Cash flow forecast

Edit Format

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	A	B	C	D	E	F	G	H	I
36									
37		Sales are expected to increase in 20X6 when the new processing facility opens in Farland. The new product ranges are expected to be very popular and the product launch will be supported by an advertising campaign. In addition to output from the new processing facility, production levels at existing facilities are planned to increase by at least 10%.							
38									
39	2	On average, cash is received from customers in the following pattern:							
40		25% in month of sale							
41		50% following month of sale							
42		25% two months after sale							
43									
44	3	Operating expenses are forecast to increase over the three-year period as production increases. The company is expecting to benefit from economies of scale as production increases at each processing facility.							
45									
46	4	The new processing facility is planned to commence production on 31 March 20X6.							
47									
48									

Section B – question 3

AAA-INT September/December 2021 exam (21/22 syllabus)

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Exhibits

1. Arjan Co
2. Barnaby Co

Requirements

Requirement a (15 marks)

Requirement b (10 marks)

Response Options

Word Processor

It is 1 July 20X5. You are an audit manager in Sol & Co, a firm of Chartered Certified Accountants. You are currently working on two existing clients.

Arjan Co and Barnaby Co are both manufacturing companies with a financial year end of 31 March 20X5. Both audits are in the completion phase and you are in the process of reviewing the audit files.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Arjan Co – selected results of the subsequent events and final analytical procedures which have been performed by the audit team.
2. Barnaby Co – a copy of the schedule of uncorrected misstatements which have been recorded during the audit.

This information should be used to answer the question **requirements** within the **response option** provided.

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Requirement a

Requirement a (15 marks)

Using Exhibit 1 – Arjan Co:

(a)(i) Evaluate the results of the subsequent events and final analytical procedures, commenting on any inconsistencies in relation to the audit evidence gathered; and

(a)(ii) Recommend the further actions to be taken, including suitable audit procedures, which will enable the auditor to reach a conclusion on each matter.

(15 marks)

Requirement b

Requirement b (10 marks)

Using Exhibit 2 – Barnaby Co:

(b) Recommend and explain the matters which should be discussed with management in relation to each of the uncorrected misstatements, including an assessment of the individual impact on the auditor's opinion if management does not make any changes.

Note: The following mark allocation is provided as guidance for this question:

(i) Grant (6 marks) (ii) Machine sale (4 marks)

(10 marks)

Exhibit 1

1. Arjan Co

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Arjan Co's draft financial statements show revenue of $120 million (20X4: $114 million), profit before tax of $11 million (20X4: $10·4 million) and total assets of $56 million (20X4: $74 million).

As part of your review of the audit file, you are considering the following results of the subsequent events procedures and final analytical procedures.

Subsequent events procedures

Newspaper reports in June 20X5 revealed that Cami Co, a significant customer of Arjan Co, entered liquidation and creditors are unlikely to receive more than 20% of amounts outstanding. The amount outstanding from Cami Co at 31 March 20X5 was $0·8 million. None of the amount outstanding has been received to date. No further work has been performed as a result of these procedures.

An extract of the final analytical procedures prepared by the audit assistant

Ratio	20X5	20X4	Auditor expectation	Comment	Corroborating evidence
Inventory value	$4 million	$25 million	Inventory has fallen by 84% in the year. This is in line with expectations as in November 20X4 management moved to a just-in-time (JIT) system for managing inventory.	The significant fall in inventory levels is consistent with a reduction in holding period.	Auditor attendance at year-end inventory count, sample counts performed and count controls observed. No inaccuracies were identified. No further work over the completeness, accuracy and existence of inventory required.
Inventory holding period	15 days	94 days	Movement to JIT will reduce inventory holdings, so movement is in line with expectations. Per management lead times with suppliers average 20 days, hence inventory holding period is expected to be 20 days.	Inventory holding of 15 days appears to be shorter than expected. Management states that holdings are less than 20 days as customer orders are manufactured one week after an order is placed.	A sample of customer contract terms was reviewed and confirmed that they state that orders are expected to be manufactured within five working days with fulfilment within 10 working days of order. This is consistent with the company's advertised terms and therefore supports the reduction in inventory holding period.

1

1. Arjan Co

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1

Write down for obsolete inventory as % of inventory held	10%	5%	The move to a JIT system should eliminate obsolete inventory and the need for a write down, so the expectation would be that write downs would be lower or close to 0.	Management has advised that they do not currently have sufficient experience with the new system to ensure only required inventory has been ordered. As a result, they have taken a cautious approach to the write down.	Total write down for obsolete inventory of $0·4 million in 20X5 is lower than the 20X4 amount of $1·25 million. This is less than 5% of profit before tax and therefore immaterial, so no further work performed.
Receivables collection period	53 days	49 days	No changes in credit period have been enacted in the year, hence the collection period is expected to remain in line with prior years.	The increase in the receivables collection period relates to the slow payment of invoices by Cami Co, a major customer. The financial controller is confident that payment will be made.	Outstanding invoice agreed to trade receivables ledger and a sample of customer confirmations of the balance owed were obtained in writing.
Allowance for irrecoverable receivables as % of total receivables	3%	5%	No changes have been made to controls over receivables during the year, so the allowance is expected to be in line with prior years.	The financial controller reviewed all trade receivables at the year end and concluded that fewer defaults were expected than in the prior year, hence the reduction in the allowance.	Total fall in allowance of $0·5 million is below 5% of profit before tax and is therefore immaterial. No further work was performed.

2

Exhibit 2

2. Barnaby Co

You are preparing for a discussion with the management of Barnaby Co about misstatements identified in the financial statements during the audit for the year ended 31 March 20X5. The audit working papers contain the following schedule of uncorrected misstatements prepared by the audit team. Barnaby Co's financial statements, prior to any adjustment for the items below, show profit before tax of $43 million (20X4: $45 million) and total assets of $105 million (20X4: $120 million).

Schedule of uncorrected misstatements

		Statement of profit or loss		Statement of financial position	
		Debit	Credit	Debit	Credit
		$million	$million	$million	$million
(i)	Government grant	5	–	–	5
(ii)	Machinery sale	1	–	–	1
	Total	6	–	–	6

(i) Government grant

Barnaby Co received a government grant on 31 December 20X4 to invest in new machinery. A condition of the grant requires the funds to be invested within 12 months of the grant date or it becomes repayable. The grant has been recognised in full in the statement of profit or loss for the year, however, the machinery has not yet been purchased. The finance director of Barnaby Co assured the audit team that the money will be invested by 30 September 20X5.

(ii) Machine sale

On 31 March 20X5, Barnaby Co sold a machine which was no longer in use. Under the terms of the sale agreement, the total sales price of the machine of $10 million would be paid on 31 March 20X6. The company has recognised the full sales value of $10 million when calculating profit on disposal for the asset and for the value of the receivable in the current year financial statements. The audit team has calculated that the net present value of the receivable at the reporting date of 31 March 20X5 is $9 million and therefore the profit on disposal and the receivable are overstated at the reporting date by $1 million. This is based on the company's cost of capital of 10% which has been calculated by the client. Sufficient and appropriate evidence has been obtained in relation to this calculation to conclude that 10% is an appropriate cost of capital.