

Fundamentals Level – Skills Module

Audit and Assurance

March/June 2016 – Sample Questions



Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

This question 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 question 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 question paper.

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

8 F Paper

Think Ahead

ACCA

The Association of
Chartered Certified
Accountants

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 manager of Satsuma & Co and have been assigned to the audit of Tangerine Tech Co (Tangerine), a company which is planning to list on a stock exchange within six months. The listing rules of the stock exchange require compliance with corporate governance principles, and the directors are unsure whether they are following best practice in relation to this. They have asked the audit engagement partner for their view on this matter.

Tangerine's board is comprised of six executive directors, a non-executive chairman and three other non-executive directors (NEDs). The chairman and one of the NEDs are former executive directors of Tangerine and on reaching retirement age were asked to take on non-executive roles. The company has established an audit committee, and all NEDs are members including the chairman who chairs the committee. All four members of the audit committee were previously involved in sales or production related roles.

All of the directors have been members of the board for at least four years. As the chairman does not have an executive role, he has sole responsibility for liaising with the shareholders and answering any of their questions. The company has not established an internal audit function to monitor internal controls.

Required:

Using the information above:

Describe FIVE corporate governance weaknesses faced by Tangerine Tech Co and provide a recommendation to address each weakness to ensure compliance with corporate governance principles.

(10 marks)

- 2 (i) Describe FIVE types of procedures for obtaining audit evidence; and
(ii) For each type of procedure, describe an example relevant to the audit of BANK balances.

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

(10 marks)

- 3** Grains 4U Co (Grains) manufactures breakfast cereals and has three factories, four warehouses and three distribution depots spread across North America. The audit for the year ended 31 December 2015 is almost complete and the financial statements and audit report are due to be signed shortly. Profit before taxation is \$7.9 million. The following events have occurred subsequent to the year end and no amendments or disclosures have been made in the financial statements.

Event 1 – Fire

On 15 February 2016, a fire occurred at the largest of the distribution depots. The fire resulted in extensive damage to 40% of the company's vehicles used for dispatching goods to customers; however, there have been no significant delays to customer deliveries. The company estimates the level of damage to the vehicles to be in excess of \$650,000. Only a minimal level of inventory, approximately \$25,000, was damaged. Grain's insurance company has started to investigate the fire to assess the likelihood and level of payment, however, there are concerns the fire was started deliberately, and if true, would invalidate any insurance cover.

Event 2 – Inventory

On 18 February 2016, it was discovered that a large batch of Grain's new cereal brand 'Loopy Green Loops' held in inventory at the year end was defective, as the cereal contained too much green food colouring. To date no sales of this new cereal have been made. The cost of the defective batch of inventory is \$915,000 and the defects cannot be corrected. However, the scrapped cereal can be utilised as a raw material for an alternative cereal brand at a value of \$50,000.

Required:

For each of the two subsequent events described above:

- (i) Based on the information provided, explain whether the financial statements require amendment; and**
- (ii) Describe audit procedures which should now be performed in order to form a conclusion on any required amendment.**

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

(10 marks)

- 4** Kyanite Pizzas Co (Kyanite) operates a large chain of fast food restaurants. You are an audit supervisor of Jasper & Co and are currently preparing the audit programmes for the audit of Kyanite's financial statements for the year ended 31 March 2016. You are reviewing the notes of last week's meeting between the audit manager and finance director where two material issues were discussed.

(i) Property, plant and equipment

In the past Kyanite has received negative press reports over the condition of its fast food restaurants, with comments suggesting they are old fashioned and tired looking. Therefore during the year the company undertook a full review of all its assets and carried out extensive refurbishments to the majority of its restaurants. This review resulted in a significant amount of ageing fixtures and fittings being disposed of and a significant amount of capital expenditure was invested in all remaining restaurants. (6 marks)

(ii) Equity

The refurbishment was financed via a share issue in April 2015 at a premium of \$1.6 million. (4 marks)

Required:

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

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

(10 marks)

5 You are an audit senior of Hessonite & Co and are in the process of reviewing the inventory system documentation for your audit client, Lemon Quartz Co (Quartz) which manufactures computer equipment. The company's factory and warehouse are based on one large site, and their year end is 30 June 2016. Quartz is planning to undertake a full inventory count at the year end of its raw materials, work in progress and finished goods and you will be attending this count. In preparation you have been reviewing the inventory count instructions for finished goods provided by Quartz.

The count will be undertaken by 15 teams of two counters from the warehouse department with Quartz's financial controller providing overall supervision. Each team of two is allocated a number of bays within the warehouse to count and they are provided with sequentially numbered inventory sheets which contain product codes and quantities extracted from the inventory records. The counters move through each allocated bay counting the inventory and confirming that it agrees with the inventory sheets. Where a discrepancy is found, they note this on the sheet.

The warehouse is large and approximately 10% of the bays have been rented out to third parties with similar operations; these are scattered throughout the warehouse. For completeness, the counters have been asked to count the inventory for all bays noting the third party inventories on separate blank inventory sheets, and the finance department will make any necessary adjustments.

Some of Quartz's finished goods are high in value and are stored in a locked area of the warehouse and all the counting teams will be given the code to access this area. There will be no despatches of inventory during the count and it is not anticipated that there will be any deliveries from suppliers.

Each area is counted once by the allocated team; the sheets are completed in ink, signed by the team and returned after each bay is counted. As no two teams are allocated the same bays, there will be no need to flag that an area has been counted. On completion of the count, the financial controller will confirm with each team that they have returned their inventory sheets.

Required:

(a) In respect of the inventory count procedures for Lemon Quartz Co:

- (i) Identify and explain FIVE deficiencies;**
- (ii) Recommend a control to address each of these deficiencies; and**
- (iii) Describe a TEST OF CONTROL the external auditors would perform to assess if each of these controls, if implemented, is operating effectively.**

Note: The total marks will be split equally between each part. (15 marks)

(b) Quartz's finance director has asked your firm to undertake a non-audit assurance engagement later in the year. The audit junior has not been involved in such an assignment before and has asked you to explain what an assurance engagement involves.

Required:

Explain the five elements of an assurance engagement. (5 marks)

(20 marks)

6 (a) Define audit risk and the components of audit risk.

(5 marks)

You are an audit supervisor of Amethyst & Co and are currently planning the audit of your client, Aquamarine Co (Aquamarine) which manufactures elevators. Its year end is 31 July 2016 and the forecast profit before tax is \$15.2 million.

The company undertakes continuous production in its factory, therefore at the year end it is anticipated that work in progress will be approximately \$950,000. In order to improve the manufacturing process, Aquamarine placed an order in April for \$720,000 of new plant and machinery; one third of this order was received in May with the remainder expected to be delivered by the supplier in late July or early August.

At the beginning of the year, Aquamarine purchased a patent for \$1.3 million which gives them the exclusive right to manufacture specialised elevator equipment for five years. In order to finance this purchase, Aquamarine borrowed \$1.2 million from the bank which is repayable over five years.

In January 2016 Aquamarine outsourced its payroll processing to an external service organisation, Coral Payrolls Co (Coral). Coral handles all elements of the payroll cycle and sends monthly reports to Aquamarine detailing the payroll costs. Aquamarine ran its own payroll until 31 December 2015, at which point the records were transferred over to Coral.

The company has a policy of revaluing land and buildings and the finance director has announced that all land and buildings will be revalued at the year end. During a review of the management accounts for the month of May 2016, you have noticed that receivables have increased significantly on the previous year end and against May 2015.

The finance director has informed you that the company is planning to make approximately 65 employees redundant after the year end. No decision has been made as to when this will be announced, but it is likely to be prior to the year end.

Required:

(b) Describe SIX audit risks, and explain the auditor's response to each risk, in planning the audit of Aquamarine Co. (12 marks)

(c) Explain the additional factors Amethyst & Co should consider during the audit in relation to Aquamarine Co's use of the payroll service organisation. (3 marks)

(20 marks)

End of Question Paper