

ACCA REVISION MOCK B

# Audit and Assurance

December 2017

**Time allowed: 3 hours and 15 minutes**

Section A – ALL 15 questions are compulsory and MUST be attempted

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

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

**You must NOT write in your answer booklet until instructed by the supervisor.**

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

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# Paper F8



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**SECTION A – ALL 15 QUESTIONS ARE COMPULSORY AND MUST BE ATTEMPTED**

Please use the grid provided on page two of the Candidate Answer Booklet to record your answers to each multiple choice question. Do not write out the answers to the MCQs on the lined pages of the answer booklet.

Each question is worth 2 marks

The following scenario relates to questions 1–5

You are the audit manager in the audit firm of Dark & Co. One of your audit clients is NorthCee Co, a company specialising in the manufacture and supply of sporting equipment. NorthCee has been an audit client for seven years during which time the audit partner has remained unchanged.

Following an initial meeting with the directors of NorthCee, you have obtained the following information.

- (i) NorthCee recently listed on a recognised stock exchange making it the highest profile client of your firm.
- (ii) You have been asked to continue to prepare the company’s financial statements as in previous years.
- (iii) As the company’s auditors, NorthCee would like you and the audit partner to attend an evening reception where NorthCee will present their listing arrangements to banks and existing major shareholders.
- (iv) The taxation authority is disputing the legality of certain items as allowable for taxation purposes which your firm advised NorthCee to claim. NorthCee has indicated that the fee for this advice will only be paid once the taxation authorities have agreed the company’s taxation liability.
- (v) The audit partner has just inherited 5% of NorthCee’s share capital following the death of a distant relative.

**1 Select the option which correctly identifies the primary threat to objectivity in respect of the numbered information provided.**

	<b>Advocacy</b>	<b>Self-interest</b>	<b>Self-review</b>
A	(iii)	(i), (iv), (v)	(ii)
B	(iii), (iv)	(i), (ii), (v)	n/a
C	(i), (iv)	(iii)	(ii), (v)
D	(ii)	(v)	(i), (iii), (iv)

**2 Which of the following is the most appropriate safeguard in respect of the inheritance of shares?**

- A Sell the shares immediately
- B No safeguard is necessary as the shareholding is less than 15% of the total share capital
- C Remove the partner from the team
- D Resign from the audit

- 3 Which of the following statements is/are true in respect of the outstanding tax fee?**
- (1) The significance of the threat increases with the value of the fee that is unpaid and the length of time for which it remains unpaid.
  - (2) The threat is not significant as it relates to the tax services and not audit services.
  - (3) The audit team should not include anyone involved in the tax services.
  - (4) The audit firm should consider ceasing any further work until the outstanding fees are paid.
- A (2) only  
B (2) and (3) only  
C (1), (2) and (4)  
D (1) and (4) only
- 4 As NorthCee is now listed, which TWO of the following will affect the audit that were not REQUIRED to be considered when NorthCee was not listed?**
- (1) Engagement quality control review.
  - (2) Partner rotation.
  - (3) Ownership of shares.
  - (4) Relationships between the audit staff and client.
- A (1) and (2)  
B (2) and (3)  
C (3) and (4)  
D (1) and (4)
- 5 Which of the following statements best describes the action the audit firm should take as a result of the request to prepare NorthCee's financial statements?**
- A The audit firm should ensure the audit team staff are different to those responsible for preparing the financial statements
  - B The audit firm should consult with the audit committee of NorthCee and obtain their approval to prepare the financial statements
  - C The audit firm should consider whether the combined fees for the audit and preparation of the financial statements will create undue dependence on the client
  - D The audit firm should not prepare the financial statements for NorthCee

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**The following scenario relates to questions 6–10**

Porthos is an online retailer of sports equipment, specialising in racquet sports such as tennis, squash and badminton. The company has over 150 different types of racquets available in inventory, each identified via a unique product code.

Customers place their orders directly on the internet site. Most orders are for one or two racquets only. The ordering/sales software automatically verifies the order details, customer address and credit card information prior to orders being confirmed and goods being despatched.

You are the audit manager in charge of the audit of Porthos, and you have just started planning the audit of the sales system. You have decided to use computer-assisted audit techniques (CAATs) for the first time this year.

If the sales system is found to be working effectively, the audit plan relating to sales revenue will include a mixture of analytical procedures and tests of detail as in previous years.

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**6 Which of the following statements is true in respect of CAATs that can be used to test the effectiveness of the sales system of Porthos?**

- A Test data will be used to test the effectiveness of the sales system.
- B Audit software will be used to test the effectiveness of the sales system.
- C Audit software will enable the programmed controls within the sales system to be tested.
- D Test data can be used to test calculations and manipulate data for further investigation by the auditor.

**7 Which of the following are examples of test data that the auditor can use during the audit of Porthos' sales system?**

- (1) Input of an order for a negative number of tennis racquets to ensure only positive quantities are accepted.
  - (2) Recalculate the sales day book to confirm arithmetical accuracy.
  - (3) Input of invalid customer credit card details. Online checking of credit card details to the credit card company ensures that goods cannot be despatched without payment.
  - (4) Input an invalid inventory code to ensure that the computer detects the invalid code.
- A (2) only
  - B (1), (3) and (4) only
  - C (1), (2), (3) and (4)
  - D (1) and (4) only

**8 Porthos is considering upgrading its sales system next year. Which of the following statements are true in respect of the system upgrade?**

- (1) The audit firm should consider delaying the use of CAATs until the new system is in place.
- (2) If Porthos upgrades to a standard off-the-shelf package, the cost of using CAATs is likely to be cheaper than if a bespoke system is implemented.
- (3) The external auditor should be involved in the selection and design of the new system in order to ensure CAATs can be used for the external audit.
- (4) The audit is likely to be cheaper in the year of upgrade as CAATs enable audit procedures to be performed more cost effectively.

- A (1), (2), (3) and (4)
- B (1) and (2) only
- C (2), (3) and (4) only
- D (1), (2) and (4) only

**9 Choose the option which correctly identifies the type of procedure described as either an analytical procedure or a test of detail.**

- (1) Agree the total revenue from the sales day book to the financial statements.
- (2) Calculate the gross profit margin and compare with last year.
- (3) Trace the last 30 sales before the year-end and the first 30 sales after the year-end to the sales day book to ensure they are correctly included or excluded respectively.
- (4) Obtain a breakdown of sales by month and assess whether the sales are in line with your expectation taking seasonality of sales into consideration.

	<b>Analytical procedure</b>	<b>Test of detail</b>
A	(1)	(2), (3), (4)
B	(1), (2), (4)	(3)
C	(2), (4)	(1), (3)
D	(3), (4)	(1), (2)

**10 Testing of the sales system identified that in some cases, an order had been received and processed, but the sale did not appear in the sales day book. Which financial statement assertion is affected by this issue?**

- A Occurrence
- B Accuracy
- C Completeness
- D Existence

**The following scenario relates to questions 11–15**

You are the audit manager in Marigold & Co. The following issues have arisen during the course of the audit of Primrose Co. Profit before tax is \$7m.

**Claim**

Primrose received a claim from a customer of \$1m relating to a defective product purchased before the year-end. The outcome of the case is uncertain at the moment and Primrose has not made any reference to the claim in the financial statements. Audit evidence has been obtained directly from the solicitor of Primrose which indicates the case has merit and as such it is possible Primrose will have to pay compensation to the customer.

**Receivable**

A customer owing a balance of \$50,000 is experiencing significant cash flow difficulties. Primrose believes the debt will be paid as the customer has been trading with them for a number of years. As a result the debt has not been written off in the financial statements.

**11 In respect of the claim, which of the following correctly summarises the appropriate accounting treatment and whether the amount of the claim is material or not?**

	<b>Accounting treatment</b>	<b>Material</b>
A	Recognise	Yes
B	No recognition or disclosure required	No
C	Recognise	No
D	Disclose	Yes

**12 Assuming that no amendment to the financial statements is made in respect of the claim, which of the following options correctly summarises the impact to the audit opinion?**

	<b>Opinion type</b>	<b>Opinion wording</b>
A	Disclaimer	Do not express an opinion
B	Unmodified	Financial statements give a true and fair view
C	Qualified	‘Except for’
D	Adverse	Financial statements do not give a true and fair view

**13 Which of the following statements is true in respect of the receivable?**

- A The potentially irrecoverable debt does not need to be accounted for until the customer ceases trading
- B The potentially irrecoverable debt does not need to be accounted for unless it is material to the financial statements
- C The client should write off or make allowance for the debt as there is uncertainty as to its recoverability
- D The auditor should contact the customer directly to ask them whether the balance will be paid

**14 Assuming no action is taken in respect of the receivable, which of the following options correctly summarises the impact to the audit opinion?**

	<b>Opinion type</b>	<b>Opinion wording</b>
A	Disclaimer	Do not express an opinion
B	Adverse	Financial statements do not give a true and fair view
C	Qualified	'Except for'
D	Unmodified	Financial statements give a true and fair view

**15 Choose the option which correctly states whether or not an emphasis of matter paragraph would be required in the auditor's report for each of the two issues.**

	<b>Claim</b>	<b>Receivable</b>
A	Emphasis of matter not required	Emphasis of matter not required
B	Emphasis of matter not required	Emphasis of matter required
C	Emphasis of matter required	Emphasis of matter not required
D	Emphasis of matter required	Emphasis of matter required

**SECTION B – ALL THREE QUESTIONS ARE COMPULSORY AND MUST BE ATTEMPTED**

**16 (a) Explain THREE contents every working paper should contain. (3 marks)**

You are an audit senior in Koeman & Co and you are planning the audit of a new client, Goodison Co, for the year-ended 30 June 20X7. The audit manager has already had a planning meeting with the finance director. He has provided you with the following notes of his meeting and financial statement extracts.

The company recognises revenue when the customer places an order as 95% of orders are processed and despatched the day they are received.

Goodison’s management have reduced the allowance for doubtful receivables from 4% of receivables to 2% of receivables, as they claim that there is a lower risk of irrecoverable debts since the company employed an additional person in the credit control department.

Inventory is valued at cost and management then performs a review of the aged inventory listing to identify any write downs required. Inventory that is more than 180 days old is written down by 20%.

The directors have agreed to pay themselves a profit related bonus for the year.

**Financial statement extracts for year-ended 30 June 20X7**

	<i>DRAFT</i> 20X7	<i>ACTUAL</i> 20X6
	\$m	\$m
Revenue	17.25	13.0
Cost of sales	(8.25)	(7.0)
	<hr/>	<hr/>
Gross profit	9.0	5.0
Operating expenses	(5.5)	(3.0)
	<hr/>	<hr/>
Profit before interest and taxation	3.5	2.0
	<hr/>	<hr/>
Inventory	1.5	1.2
Receivables	3.5	2.0
Cash	–	1.7
Trade payables	1.2	0.8
Overdraft	0.5	–

**Required:**

**(b) Using the information provided:**

- (i) Calculate FIVE ratios, for BOTH years, which would assist in planning the audit, and (5 marks)**
- (ii) From a review of the information provided and the ratios calculated, explain SIX audit risks that arise and describe the appropriate response to these risks. (12 marks)**

- (c) Describe the substantive procedures that should be performed at the final audit to confirm the inventory balance in the financial statements at the year-end.

(5 marks)

The directors of Goodison have decided to introduce a perpetual inventory system. This is expected to be in place in 3 months' time so will not affect this year's audit but will need to be considered for next year.

- (d) Describe audit procedures the auditor should perform next year in order to place reliance on the perpetual inventory system of Goodison Co.

(5 marks)

(Total: 30 marks)

- 17 Trafford Co (Trafford) is a manufacturer of engine parts supplying parts to the major car manufacturers. The company's year-end is 31 July 20X7. You are an audit supervisor of Mourinho & Co and are currently reviewing documentation of Trafford's internal control in preparation for the interim audit.

Many car manufacturers work on a just-in-time basis which means that Trafford has to have sufficient inventory in place to meet customer demand at very short notice. The car manufacturer's inventory systems are linked to Trafford and when inventory falls to a minimum level, an order is automatically placed with Trafford. Most customer contracts require Trafford to deliver orders within 12 hours of being placed. Recently, Trafford has experienced problems with their systems which have led to orders not being processed and penalties have been incurred for breach of contractual terms. Rather than refund customers for the penalty amount, customers deduct the amount of penalty payment due from the monthly invoice and pay the net amount. No check is performed by Trafford to confirm that the amount paid by customers is equivalent to the invoiced amount less penalty payment.

In order to meet its contractual terms, Trafford's production line operates 24 hours a day. A limited number of production staff are employed to oversee the machinery as well as perform some tasks which need to be done manually. Supervisors oversee the production staff.

Maintenance contracts are taken out for machinery with regular maintenance checks taking place once every year. Until the start of the year maintenance was carried out every three months but in an effort to reduce costs, maintenance checks are now only performed annually.

Employees work eight hour shifts with three shifts per day. During holiday periods, employees are offered overtime to cover employees taking leave. As this time of year is very busy, overtime is not authorised.

Employees complete a timesheet each week which is sent directly to payroll and payment is made the following week. Due to sickness, the payroll department is understaffed and the payroll manager is currently processing all payroll payments.

**Required:**

- (a) In respect of the internal control of Trafford Co:

(i) Identify and explain FOUR deficiencies

(ii) Recommend a control to address each of these deficiencies, and

(iii) Describe a test of control to assess if each of these controls is operating effectively.

(12 marks)

- (b) Explain TWO limitations of internal controls. (2 marks)
- (c) Describe the substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to:
- (i) penalty payments
- (ii) overtime payments. (6 marks)

(Total: 20 marks)

- 18 (a) Explain the terms 'deviation' and 'misstatement'. (2 marks)
- (b) Identify and explain THREE financial statement assertions relevant to transactions and events. (3 marks)
- (c) Strypes Co is a listed company in the construction industry. You are the audit manager of Cavan & Co and the audit of Strypes Co for the year-ending 31 December 20X5 is due to commence in January 20X6. The following information has been gathered during the planning process:

**(i) New accounting system**

During 20X5 Strypes Co introduced a new accounting software package which has more functionality for contract accounting. The old and new systems were run in parallel for one month before the old system was shut down. The internal audit function performed testing during the transfer of the data from the old to the new system. (6 marks)

**(ii) Deferred income**

Strypes Co makes bespoke furniture for customers. The furniture takes between one and three months to make depending on the size of the item. Customers are required to pay a 40% deposit when placing the order. This covers the design process and materials. The remainder of the balance is paid when the customer accepts the goods. (5 marks)

**Required:**

**Describe the audit procedures you should perform to obtain sufficient, appropriate audit evidence in relation to the two matters.**

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

- (d) During the audit, the team obtained sufficient appropriate evidence that deferred income is overstated by \$125,000. The final draft of the financial statements shows profit for the year of \$850,000 and total assets of \$9 million.

The audit team spent considerable time testing the new accounting system and identified no issues. The auditor's findings in relation to the new system have been discussed at length with those charged with governance.

**Required:**

**Describe the impact the two matters will have on the auditor's report assuming that the issue in relation to deferred income is not resolved. (4 marks)**

(Total: 20 marks)

