

ACCA REVISION MOCK B

# Advanced Audit and Assurance

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

This 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 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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## SECTION A – BOTH QUESTIONS ARE COMPULSORY AND MUST BE ATTEMPTED

### 1A (INT SYLLABUS)

Your firm has recently been appointed as auditor to Island Co. Island Co is a manufacturer of machinery used in the coal extraction industry. You are currently planning the audit of the financial statements for the year ended 31 May 20X7. The draft financial statements show revenue of \$125 million (20X6 – \$103 million), profit before tax of \$5.6 million (20X6 – \$5.1 million) and total assets of \$95 million (20X6 – \$90 million). The audit partner has sent you this email:

**To: Audit manager**

**From: Audit partner**

**Subject: Audit planning – Island Co**

Hello

I would like you to start planning the audit of Island Co. I have provided you with minutes of a meeting I had last week with Kate Shannon, the company's chief executive officer, and some background information about the company. Using this information I would like you to prepare briefing notes for my use in which you:

- (a) **Evaluate the audit risks to be considered when planning the audit of Island Co.** (15 marks)
- (b) **Recommend the principal audit procedures to be performed in respect of:**
  - (i) **the estimated warranty provision.** (8 marks)
  - (ii) **opening balances.** (4 marks)
- (c) **Discuss why the identification of related parties, and material related party transactions, can be difficult for auditors.** (4 marks)

Thank you.

Island Co designs, constructs and installs machinery for five key customers. Payment is due in three instalments: 50% is due when the order is confirmed (stage one), 25% on delivery of the machinery (stage two), and 25% on successful installation in the customer's coal mine (stage three). Generally it takes six months from the order being finalised until the final installation.

At 31 May 20X7, there is an amount outstanding of \$2.85m from Jacks Mine Co. The amount is a disputed stage three payment. Jacks Mine Co is refusing to pay until the machinery is running at 100% efficiency.

Several weeks before the year end Island Co was contacted by lawyers of Sawyer Co, a customer of Island. Sawyer Co is claiming damages for injuries suffered by a drilling machine operator whose arm was severely injured when a machine malfunctioned. Kate Shannon, the chief executive officer of Island Co, has told you that the claim is being ignored as it is generally known that Sawyer Co has a poor health and safety record, and thus the accident was their fault. Two orders which were placed by Sawyer Co in the last month have been cancelled.

Work in progress is valued at \$8.5 million in the draft financial statements. A physical inventory count was held on 17 May 20X7. The chief engineer estimated the stage of completion of each machine at that date. One of the major components included in the coal extracting machinery is now being sourced from overseas. The new supplier, Locke Co, is located in Spain and invoices Island Co in Euros. There is a trade payable of \$1.5 million owing to Locke Co included within current liabilities.

All machines are supplied carrying a one year warranty. A warranty provision is recognised in the statement of financial position at \$2.5 million (20X6 – \$2.4 million). Kate Shannon estimates the cost of repairing defective machinery reported by customers, and this estimate forms the basis of the provision.

Kate Shannon owns 60% of the shares in Island Co. She also owns 55% of Pacific Co, which leases a head office to Island Co. Kate is considering selling some of her shares in Island Co in July, and would like the audit to be completed as quickly as possible.

**Required:**

**Respond to the email from the audit partner. (31 marks)**

**Note: The split of marks is shown within the partner’s email.**

**Professional marks will be awarded for the presentation, clarity of explanations and logical flow of the answer. (4 marks)**

**(Total: 35 marks)**

## 1B (UK SYLLABUS)

Your firm has recently been appointed as auditor to Island Co. Island Co is a manufacturer of machinery used in the coal extraction industry. You are currently planning the audit of the financial statements for the year ended 31 May 20X7. The draft financial statements show revenue of £125 million (20X6 – £103 million), profit before tax of £5.6 million (20X6 – £5.1 million) and total assets of £95m (20X6 – £90 million). The audit partner has sent you this email:

**To: Audit manager**

**From: Audit partner**

**Subject: Audit planning – Island Co**

Hello

I would like you to start planning the audit of Island Co. I have provided you with minutes of a meeting I had last week with Kate Shannon, the company’s chief executive officer, and some background information about the company. Using this information I would like you to prepare briefing notes for my use in which you evaluate the audit risks to be considered when planning the audit of Island Co; recommend the principal audit procedures to be performed in respect of the estimated warranty provision and opening balances; and discuss why the identification of related parties, and material related party transactions, can be difficult for auditors.

**(31 marks)**

Thank you.

Island Co designs, constructs and installs machinery for five key customers. Payment is due in three instalments: 50% is due when the order is confirmed (stage one), 25% on delivery of the machinery (stage two), and 25% on successful installation in the customer's coal mine (stage three). Generally it takes six months from the order being finalised until the final installation.

At 31 May 20X7, there is an amount outstanding of £2.85 million from Jacks Mine Co. The amount is a disputed stage three payment. Jacks Mine Co is refusing to pay until the machinery is running at 100% efficiency.

Several weeks before the year end Island Co was contacted by lawyers of Sawyer Co, a customer of Island. Sawyer Co is claiming damages for injuries suffered by a drilling machine operator whose arm was severely injured when a machine malfunctioned. Kate Shannon, the chief executive officer of Island Co, has told you that the claim is being ignored as it is generally known that Sawyer Co has a poor health and safety record, and thus the accident was their fault. Two orders which were placed by Sawyer Co in the last month have been cancelled.

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Kate Shannon owns 60% of the shares in Island Co. She also owns 55% of Pacific Co, which leases a head office to Island Co. Kate is considering selling some of her shares in Island Co in July, and would like the audit to be completed as quickly as possible.

**Required:**

**Respond to the email from the audit partner. (31 marks)**

**Professional marks will be awarded for the presentation, clarity of explanations and logical flow of the answer. (4 marks)**

**(Total: 35 marks)**

- 2** You are a manager in the quality assurance team of an audit firm and are conducting a cold review of the audit file for Da Silva Co. The audit team for Da Silva Co included Leon, the audit manager; Dominic, the audit senior; and Stephen, an audit junior.

Da Silva Co provides freight services between seven major cities. The cities are located at significant distances from each other meaning that deliveries can take several days. There were a number of protests by independent lorry drivers last year who were angry about the increased taxes on fuel. The protests involved blockading major roads which prevented traffic from getting through. This caused significant delays to Da Silva Co in reaching its customers.

You are reviewing the working paper relating to receivables which was assigned to Dominic. The working paper has not been signed and dated by Dominic. The working paper was reviewed and evidenced as reviewed by Stephen. The working paper includes the following note:

Da Silva has offered all customers affected by the delays a 30% discount on invoices issued during the delays which remain unpaid at the year-end. The total discount offered is \$53,000. This has not been reflected in the financial statements.

Moffatt Co is refusing to accept Da Silva's offer of the discount. Moffatt Co claims it lost out on a significant contract because of the delay and is refusing to pay the full invoiced amount of \$72,000.

An after date cash review of receivables was carried out. All invoices relating to customers other than Moffatt Co have been paid post year-end. As there were no issues identified with these no details have been retained on file stating which customers and invoices were tested.

The financial statements showed a profit of \$1.6 million and total assets of \$9 million.

**Required:**

- (a) In relation to the receivables:**
- (i) Comment on the matters that should have been considered, and**
  - (ii) Recommend further audit procedures that should have been performed.** (7 marks)
- (b) Critically evaluate the engagement performance of the audit of Da Silva Co and state any further actions that should now be taken by the audit firm.** (10 marks)

Da Silva Co is planning to obtain a stock exchange listing next year. Regulations in the country Da Silva Co is based require listed companies to prepare interim financial statements and have them independently reviewed. A report expressing limited assurance should be issued.

**Required:**

- (c) Describe the procedures an independent reviewer will perform to obtain sufficient appropriate evidence to provide a conclusion on the interim financial statements.** (8 marks)

**(Total: 25 marks)**

**SECTION B – TWO QUESTIONS ONLY TO BE ATTEMPTED**

- 3 Mac Co is a large, private company, whose business activity is events management, involving the organisation of conferences, meetings and celebratory events for companies. Mac Co was founded 10 years ago by Danny Hudson and his sister, Stella, who still own the majority of the company's shares. The company has grown rapidly and now employs more than 150 staff in 20 offices.

You are a manager in the business advisory department of Flack & Co. Your firm has just been engaged to provide the internal audit service to Mac Co. In your initial conversation with Danny and Stella, you discovered that currently there is a small internal audit team, under the supervision of Lindsay Montana, a recently qualified accountant. Before heading up the internal audit department, Lindsay was a junior finance manager of the company. The members of the internal audit team will be reassigned to roles in the finance department once your firm has commenced the provision of the internal audit service.

Mac Co is not an existing client of your firm, and to gain further understanding of the company, you held a meeting with Lindsay Montana. Notes from this meeting are shown below.

**Notes of meeting held with Lindsay Montana**

The internal audit team has three employees, including Lindsay, who reports to the finance director. The other two internal auditors are currently studying for their professional examinations. The team was set up two years ago, and initially focused on introducing financial controls across all of Mac Co's offices. Nine months ago the finance director instructed the team to focus their attention on introducing operational controls in order to achieve cost savings due to a cash flow problem being suffered by the company. The team does not have time to perform much testing of financial or operational controls.

In the course of her work, Lindsay finds many instances of management policies not being adhered to, and the managers of each location are generally reluctant to introduce controls as they want to avoid bureaucracy and paperwork. As a result, Lindsay's recommendations are often ignored.

Three weeks ago, Lindsay discovered a fraud operating at one of the offices while reviewing the procedures relating to the approval of new suppliers and payments made to suppliers. The fraud involved an account manager authorising the payment of invoices received from fictitious suppliers, with payment actually being made into the account manager's personal bank account. Lindsay reported the account manager to the finance director, and the manager was immediately removed from office. This situation has highlighted to Danny and Stella that something needs to be done to improve controls within their organisation.

Danny and Stella are deciding whether to set up an audit committee. Under the regulatory framework in which it operates, Mac Co is not required to have an audit committee, but a disclosure note explaining whether an audit committee has been established is required in the annual report.

**Required:**

- (a) Evaluate the benefits specific to Mac Co of outsourcing its internal audit function. (6 marks)
- (b) Explain the potential impacts on the external audit of Mac Co of outsourcing its internal audit function. (4 marks)
- (c) Recommend procedures that could be used by your firm to quantify the financial loss suffered by Mac Co as a result of the fraud. (5 marks)
- (d) Assess the benefits and drawbacks for Mac Co in establishing an audit committee. (5 marks)

**(Total: 20 marks)**

**4** You are an audit manager in Nate & Co, a firm of Chartered Certified Accountants. You are reviewing three situations, which were recently discussed at the monthly audit managers' meeting:

- (1) Nate & Co has recently been approached by a potential new audit client, Fisher Co. The firm is keen to take the appointment and is currently carrying out client acceptance procedures. Fisher Co was recently incorporated by Marcellus Fisher, with its main trade being the retailing of wooden storage boxes.
- (2) Nate & Co provides the audit service to CF Co, a national financial services organisation. Due to a number of errors in the recording of cash deposits from new customers that have been discovered by CF Co's internal audit team, the directors of CF Co have requested that your firm carry out a review of the financial information technology systems. It has come to your attention that while working on the audit planning of CF Co, Jin Sayed, one of the juniors on the audit team, who is a recent information technology graduate, spent three hours providing advice to the internal audit team about how to improve the system. As far as you know, this advice has not been used by the internal audit team.
- (3) LA Shots Co is a manufacturer of bottled drinks, and has been an audit client of Nate & Co for five years. Two audit juniors attended the annual inventory count last Monday. They reported that Brenda Mangle, the new production manager of LA Shots Co, wanted the inventory count and audit procedures performed as quickly as possible. As an incentive she offered the two juniors ten free bottles of 'Super Juice' from the end of the production line. Brenda also invited them to join the LA Shots Co office party, which commenced at the end of the inventory count. The inventory count and audit procedures were completed within two hours (the previous year's procedures lasted a full day), and the juniors then spent four hours at the office party.

**Required:**

- (a) Define 'money laundering' and state the procedures specific to money laundering that should be considered before, and on the acceptance of, the audit appointment of Fisher Co. (5 marks)
- (b) With reference to CF Co, identify and explain the ethical and other professional issues raised. (9 marks)
- (c) Identify and explain the ethical and professional matters raised at the inventory count of LA Shots Co. (6 marks)

**(Total: 20 marks)**

- 5 (a) Compare and contrast the responsibilities of management, and of auditors, in relation to the assessment of events after the reporting period (subsequent events). You should include a description of appropriate audit procedures. (9 marks)

- (b) You are a manager at Widdicombe & Co. You are currently reviewing the working files for two audits, both with a year-end of 31 March 20X7. In particular you have identified the following issues:

**Hills Co**

The Chairman's report of Hills Co states that investment property rental forms a major part of revenue. However, a note to the financial statements shows that property rental represents only 1.6% of total revenue for the year. The audit senior is satisfied that the revenue figure in the financial statements is correct. The audit senior has noted that an unmodified auditor's report should be given as the audit opinion does not extend to the other reports. (5 marks)

**Brooker Co**

Procedures on the audit of Brooker Co identified a transfer of cash from Harman Co 15 April 20X7. The audit senior documented a discussion with the FD of Brooker, who explained that Harman commenced trading on 4 April 20X7, after being set up as a wholly-owned subsidiary of Brooker. The audit senior has noted that, although no other evidence has been obtained, an unmodified opinion is appropriate because the matter does not impact on the current year's financial statements. (6 marks)

**Required:**

**Critically evaluate the suitability of the audit senior's proposals for the auditors' reports.**

**Note: the mark allocation is shown against each of the issues.**

**(Total: 20 marks)**

## REFERENCES

The Board (2016) *IAS® 10 Events after the Reporting Period*. London: IFRS Foundation.

The Board (2016) *IAS 21 The Effects of Changes in Foreign Exchange Rates*. London: IFRS Foundation.

The Board (2016) *IAS 24 Related Party Disclosures*. London: IFRS Foundation.

The Board (2016) *IAS 37 Provisions, Contingent Liabilities and Contingent Assets*. London: IFRS Foundation.

The Board (2016) *IFRS® 9 Financial Instruments*. London: IFRS Foundation.

The Board (2016) *IFRS 15 Revenue from Contracts with Customers*. London: IFRS Foundation.