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# ACCA – Paper P7 Advanced Audit and Assurance June 2015 Final Assessment

### Instructions

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- All scripts should ideally be submitted to your Kaplan centre for marking via email to help speed up the marking process. Please scan this form and your answer script in a single PDF and email it to your Kaplan centre.
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## Marking Report

### Notice to Markers

- 1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

• Time management	• Handwriting	• Presentation and layout	• Use of English
• Points clearly and concisely made	• Relevance of answers to question	• Coverage and depth of answer	• Accuracy of calculations
• Calculations cross-referenced to workings	• All parts of the requirement attempted	• Length of answers equates to marks available	• Read the question carefully

- 2 For each question, please provide suitable constructive comments

Question Number	General Comments	Exam Technique Comments

**ACCA FINAL ASSESSMENT**

# **Advanced Audit and Assurance**

**June 2015**

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

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.**

**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.**

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

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**Paper P7**

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## SECTION A

### BOTH questions are compulsory and MUST be attempted

- 1 (a) You have just received the following email from the engagement partner for Paragus Co, a listed company.

<b>To:</b>	<b>Audit Manager</b>
<b>From:</b>	<b>Audit Partner</b>
<b>Date:</b>	<b>30 March 2015</b>
<b>Regarding: Paragus – Audit Planning</b>	
Hello	
I have just returned from a meeting at Paragus Co, a new audit client, where I obtained some background information for the audit. I have attached the notes from my meeting.	
(i)	I would like you to start to plan the audit by preparing a briefing note for me in which you evaluate the business risks facing Paragus Co to be considered when planning the audit for the year ended 30 June 2015. <b>(12 marks)</b>
There are a number of new members in our department and I would like to provide them with some initial training. I have asked them to provide me with a list of questions that I will answer in a team briefing next week. One of the new recruits has asked me to explain why we need to perform a risk assessment. They have started their exam training and so they should know that the auditor needs to identify and evaluate the risk of material misstatement in the financial statements and design and implement appropriate responses to the risks identified. However, they may not have been told about the importance of business risk to the auditor.	
(ii)	Please also include an explanation of why the auditor needs to obtain an understanding of business risk in your briefing notes. <b>(7 marks)</b>
Thank you.	

#### Attachment: Notes from the meeting

Paragus Co is a dedicated online supermarket, i.e. it sells grocery products purely online without any physical supermarket stores, operating in Groceryland, a country famous for its inclement weather. Paragus offers delivery of grocery products to customers within a 300 mile radius, centrally picked from a single, highly automated warehouse. Grocery products include fresh fruit, vegetables, meat, dairy, and fish as well as packaged goods. Suppliers deliver goods to the warehouse using large lorries. Paragus delivers goods to customers using small vans.

Customers pay for goods via the company's website. The website and payment processing systems are outsourced to a specialist company. The business and IT systems and intellectual property are not protected by patents or registered design rights.

Paragus sells more than 20,000 different products, the majority of which are sourced through Le Supermarché, a leading supermarket chain in a neighbouring country. Approximately 25% of the products sold by Paragus are Le Supermarché-branded products. Paragus has recently introduced its own small but expanding range of Paragus branded products. Paragus has the right to use the Le Supermarché brand on its website and delivery vans.

The agreement restricts the percentage of products which can be sourced from other suppliers, and the extent to which Paragus' own-label products can be expanded. There is also a significant termination penalty.

During the year, Paragus entered into a lease of a large warehouse and adjoining land, 200 miles north of the existing site in order to enable it to expand the geographical area to which it can deliver. Paragus is fitting-out the warehouse for use within the next two years. The machinery and interior steelwork for the warehouse are being purchased from suppliers based in the Oatezone, a region which operates a single currency, the Oate. Paragus is not part of the Oatezone.

There have been two incidents of note during the year for Paragus. Firstly, one of the workmen fitting-out the new warehouse was injured by an excavator machine whilst at work. Secondly, a customer contracted food poisoning which they believe was caused by meat purchased from Paragus.

Paragus has a \$50 million debt facility, which it is using primarily to fund the new warehouse. The terms of the facility specify that it can be withdrawn if Paragus' sourcing agreement with Le Supermarché is terminated for any reason.

Paragus granted ten thousand share options to each of the three directors on 1 July 2014, subject to the directors being employed on 30 June 2017 when the options vest. This incentive has been offered in order to retain these key individuals. The fair value of each option on 1 July 2014 was \$15. The options will only vest if Paragus' share price reaches \$17.50. Paragus expects the options to vest, although it is expected that one of the directors will not be working for Paragus by 2017.

**Required:**

**Respond to the partner's email. (19 marks)**

**Professional marks will be awarded in part (a) for the presentation and clarity of your answer. (4 marks)**

**(b) Using the specific information provided, identify and explain the risks of material misstatement in respect of:**

**(i) The lease of the land adjoining the new warehouse; and (3 marks)**

**(ii) The share options. (4 marks)**

**(c) Describe the principal audit procedures to be performed in respect of the measurement of the share-based payment expense in Paragus' financial statements. (5 marks)**

**(Total: 35 marks)**

- 2 You are a manager in the forensic investigation department of your audit firm. The directors of a local property management company, Acacia Co, have contacted your department regarding a series of unusual transactions which have recently been discovered in the company, and you have been asked to look into the matter further. You have held a preliminary discussion with Grainne Harkin, the chair of the Audit Committee at Acacia Co, the notes of this conversation are shown below:

**Notes of discussion with Grainne Harkin**

The Internal Audit department at Acacia Co recently completed a piece of work reviewing the design and operating effectiveness of the controls over sales revenue.

During the review, Internal Audit identified unusually high rental charges on specific invoices to a particular local authority. There were also a series of credit notes for the same local authority, detailing discounts on rental income, which appear to bring the charges down to the normal commercial rates. These 'discounts' were refunded to the local authority each month rather than netted off the value of the monthly rental charge. The number of properties leased to this authority has increased significantly in the last six months.

Initial investigations performed last week by Grainne revealed that the local authority had no knowledge of the discounts, believing that they were already paying the commercial rates, and have confirmed that the bank account into which the discounts were being repaid is not their own. They have confirmed that the bank account belongs to an employee of the local authority, who works in the procurement department.

As soon as she realised that there may be fraud within the company, Grainne stopped any further payments in respect of the discounts. She contacted our firm as she is unsure how to proceed, and would like our firm's specialist department to conduct an investigation.

Grainne says that the Sales Director Mark Leicester, has been absent from work since she conducted her initial investigation last week, and it has been impossible to contact him. Grainne believes that he may have been involved with the suspected fraud.

Grainne has asked whether your department would be able to provide a forensic investigation, but is unsure what this would involve. Acacia Co is not an audit client of your firm.

**Required:**

- (a) Explain the steps involved in a forensic investigation into the alleged fraud at Acacia Co including examples of procedures that could be used to gather evidence. (10 marks)
- (b) Briefly explain the SIX elements of ISQC 1 *Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements*, and give examples of how a firm can apply these elements in practise. (12 marks)
- (c) Explain why it is important for a firm to conduct audits in accordance with ISQC 1. (3 marks)

**(Total: 25 marks)**

## SECTION B

### TWO questions ONLY to be attempted

- 3** You are the manager responsible for the audit of Keffler Co, a private limited company engaged in the manufacture of plastic products. The draft financial statements for the year ended 31 December 2014 show revenue of \$47.4 million (2013 – \$43.9 million), profit before taxation of \$2 million (2013 – \$2.4 million) and total assets of \$33.8 million (2013 – \$25.7 million).

The following issues arising during the final audit have been noted on a schedule of points for your attention:

- (a) In January 2014, Keffler bought the right to use a landfill site for a period of 15 years for \$1.1 million. Keffler expects that the amount of waste that it will need to dump will increase annually and that the site will be completely filled after just ten years. Keffler has charged the following amounts to the statement of profit or loss for the year to 31 December 2014:
- \$20,000 licence amortisation calculated on a sum-of-digits basis to increase the charge over the useful life of the site; and
  - \$100,000 annual provision for restoring the land in 15 years' time. **(9 marks)**
- (b) A sale of industrial equipment to Deakin Co in February 2014 resulted in a loss on disposal of \$0.3 million that has been separately disclosed on the face of the statement of profit or loss. The equipment cost \$1.2 million when it was purchased in January 2005 and was being depreciated on a straight-line basis over 20 years. **(6 marks)**
- (c) In January 2015, Keffler was banned by the local government from emptying waste water into a river because the water did not meet minimum standards of cleanliness. Keffler has made a provision of \$0.9 million for the technological upgrading of its water purifying process and included \$45,000 for the penalties imposed in 'other provisions'. **(5 marks)**

**Required:**

**For each of the above issues:**

- (i) **comment on the matters that you should consider; and**  
(ii) **state the audit evidence that you should expect to find,**

**in undertaking your review of the audit working papers and financial statements of Keffler Co for the year ended 31 December 2014.**

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

**(Total: 20 marks)**



- 4** Your firm has been approached by the managing director of Plan-it Electrical Co (Plan-it), Kojo Nkyekyer, to accept appointment as external auditor of the company. Plan-it's current auditors have notified the company that they will not be seeking re-appointment. Since Kojo Nkyekyer has approached your firm, a competitor of Plan-it has also made initial enquiries about the possibility of you becoming their auditor, on Kojo's recommendation.

Plan-it operates a franchised electricians business in Wireland, where your firm has eight offices. Plan-it has two other main lines of business: electrical installations and electrical testing/inspections. 80% of their electrical testing/inspection work is commissioned by large estate agents, in order to meet government requirements for home sales/purchases that require the vendor to provide a certificate of electrical compliance before homes can be sold. There are only ten contractors approved by the government to carry out this work. Electrical installations include everything from small jobs changing one or two sockets, to full rewiring of buildings for both individual and corporate customers. The accounting function is centralised at Plan-it's head office in Wireland. However, the processing of payroll is outsourced to a service organisation, which is responsible for payroll preparation and the submission of returns to Wireland's taxation authority.

Plan-it has grown significantly over the last eight months. Six months ago, Plan-it acquired all of the share capital of Bright Sparks, a company specialising in electrical installations in a neighbouring country, Socketland. The expansion was funded by a combination of a bank loan, and an interest free loan from the managing director, Kojo Nkyekyer. The bank loan agreement requires audited financial statements to be provided to the bank. Kojo Nkyekyer has also asked if your firm would be willing to provide a reference to support a further bank loan Plan-it are hoping to apply for.

**Required:**

- (a) Identify and explain the professional and ethical matters that should be considered in deciding whether to accept the appointment as auditor of Plan-it Electrical Co. (15 marks)**
- (b) Professional accountants are required to communicate with each other when there is a change in professional appointment (i.e. 'professional etiquette'). Explain why it is important for your firm to communicate with the previous auditor, and state the procedures involved. (5 marks)**

**(Total: 20 marks)**

5 Hampton Co is an audit client of your firm, Beeches & Co. You are the manager responsible for the audit of the financial statements for the year ended 31 December 2014. Hampton Co manages a chain of hotels, in a number of different countries. Draft profit for the year included in statement of profit or loss is \$393m, and revenue is \$1,628m. The value of total assets included in the statement of financial position is \$2,229m.

- (a) The audit work for Hampton Co is due to be finalised this week and you have set some time aside to undertake a final review of the files next week before signing the audit report. The audit senior has drafted the audit report below:

**[DRAFT] REPORT**

We have audited the accompanying financial statements of Hampton Co for the year ended 31 December 2014.

Our responsibility is to express an opinion on these financial statements based on our audit and to plan and perform the audit to obtain assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall financial statement presentation.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the financial statements present fairly, in all material respects the financial position of Hampton Co as at December 31, 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

[Signature]

[Date signed]

Beeches & Co

Monkspath, Soliland

**Required:**

**Critically appraise the content of the audit report drafted by the audit senior, and explain any amendments that you think are necessary. (12 marks)**

- (b) The going concern section of the file includes a note stating:

‘Hampton Co has prepared forecasts covering the period to 30 September 2015. The directors are currently developing a new strategy for the company that will be launched in September 2015 and will include forecasts and projections for 1 October 2015 to 30 September 2020. Until the strategy is finalised, the directors don’t want to prepare forecasts beyond 30 September 2015.’

**Required:**

**Explain the implications for the audit report if the directors refuse to prepare forecasts beyond 30 September 2015. (4 marks)**

- (c) The listing rules in the jurisdiction of Soliland, in which Hampton is based, require that interim financial information is published half-way through the accounting period, and that the information should be accompanied by a review report issued by the company’s independent auditor.

**Required:**

**Explain the principal analytical procedures that should be used to gather evidence in a review of interim financial information. (4 marks)**

**(Total: 20 marks)**

