

ACCA INTERIM ASSESSMENT

Audit & Assurance
December 2011

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

All FIVE questions are compulsory and MUST 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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ALL FIVE questions are compulsory and MUST be attempted

- 1** Voyager is a small company that manufactures and sells high quality knitwear. Its customers are mainly fashion boutiques.

Voyager has two directors, one of whom is an executive, involved in the day-to-day administration of the business. The other is non-executive. The accounts staff include Mr Jones, who is responsible for processing revenue and receivables, and Mrs Singh, who is the purchases and wages clerk.

The company has one sales representative, who visits shops throughout the region. He is responsible for finding new clients and for generating orders from all customers. Orders are recorded on a pre-numbered two-part order form. He passes the completed forms to the accounts department. Mr Jones files one copy of the order form in numerical sequence and passes the other to the warehouse.

The completed order is despatched from the warehouse by courier, accompanied by one copy of a despatch note. The other copy is sent to Mr Jones, who prepares an invoice based on the information it contains and on the company's price list. He sends one copy of the invoice to the customer, and a second copy of the invoice is retained.

Each Friday, Mr Jones inputs the week's invoices into the computerised revenue ledger. He then files the invoices alphabetically by customer name. Despatch notes are not retained because filing space is limited.

Mr Jones opens the post daily and lists remittances received from receivables. Every Friday, he inputs the information listed to the receivables ledger. Cheques received are banked daily by the executive director.

Mr Jones reviews the accounts receivables ledger balances every month and writes to customers who have not paid within 90 days of receiving goods. The receivables ledger is printed out annually for year-end purposes. Otherwise no hard copy is printed and Mr Jones reviews the receivables ledger on the computer screen.

The company's computer package includes the facility to produce a day book and accounts receivables ledger control account. These are not used because Mr Jones considers that the low volume of transactions (10 to 15 invoices per week) makes them unnecessary.

Required:

- (a) (i) List the significant deficiencies in the sales and receivables system at Voyager. (5 marks)**
- (ii) For each deficiency explain why it is a deficiency and state how it can be overcome. (10 marks)**

During the audit you also identify the following significant points:

- (i) Mrs Singh amends the payables' master file with details of new suppliers, on the verbal authority of the executive director. A printout of amendments is not obtained.
- (ii) Mrs Singh reconciles payables ledger balances on the face of supplier statements on a monthly basis, but the statements are not retained once the accounts have been reconciled.

- (iii) At the month end Mrs Singh prints off an aged payables ledger and writes cheques to all suppliers with amounts in the 60 days or older column. She then presents the cheques to the executive director who signs them, before Mrs Singh mails them to suppliers.
- (iv) In 25% of the transactions examined, expense claims submitted by employees were not supported by receipts, even though receipts are required by company policy.

Required:

- (b) (i) **List the significant deficiencies in the purchases and wages control systems identified during the audit of Voyager. (5 marks)**
- (ii) **For each deficiency explain why it is a deficiency and state how it can be overcome. (10 marks)**

(Total: 30 marks)

- 2 (a) ISA 500 *Audit Evidence* states that 'the objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion.'

Required:

Discuss what is meant by 'sufficient appropriate' audit evidence. (5 marks)

- (b) ISA 240 *the Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* describes the responsibilities of both management and the auditor with regard to preventing and detecting fraud.

Required:

List and explain the responsibilities of both management and auditors with regard to the prevention and detection of fraud. (5 marks)

(Total: 10 marks)

- 3 Collins Cosmetics is a long-established family company that manufactures perfumes. These are sold to customers who re-package and market them under their own brand names. The company has five manufacturing units spread across its home country.

Fred Goodwin, who had been managing director for 21 years, died just over a year ago. Mike Barlow has been promoted from sales director to take over as managing director, and a new sales director has been brought in from outside the company.

The finance director, Ben Vashilli, has recently moved from a full-time to a part-time role, as he wishes to spend more time with his family. He has announced his intention to leave within the next 12 months, and the company is seeking a full-time replacement.

Profits have been falling over the last three years. The company wishes to gain a listing on the Stock Exchange, and all efforts are being focused on reversing the alarming profit trend. A bonus scheme has recently been introduced, where certain managers and directors are paid a lump sum if production exceeds a certain level.

You are the auditor of Collins Cosmetics, and are about to commence the planning for the forthcoming audit.

Required:

- (a) Explain what is meant by the following terms:
- (i) Audit risk
 - (ii) Inherent risk
 - (iii) Control risk
 - (iv) Detection risk (4 marks)
- (b) Identify the audit risks relevant to the audit of Collins Cosmetics. For each risk identified explain how this will affect the audit approach. (14 marks)
- (c) Explain how an audit strategy might be affected as a result of the auditor concluding there is high inherent risk in the audit engagement. (2 marks)

(Total: 20 marks)

- 4 You work for a firm of auditors which has seven offices throughout England and Wales. The firm's largest client, in terms of fee income, is Mart, a company which has grown steadily through a mixture of organic growth and acquisition of companies in the same industry sector.

Your firm has acted for this client since its incorporation 20 years ago and, in addition to the statutory audit, provides a range of non-audit services including tax planning (for the company and its individual directors) and consultancy work in respect of Mart's acquisition policy.

Earlier this year, the finance director of Mart retired and was succeeded by a former member of your firm's staff who had managed the audit of Mart for the preceding four years.

Required:

- (a) Identify and explain the ethical issues raised by the situation described above with regard to Mart, and state the measures that should be implemented by your firm in order to mitigate any threats to objectivity which might arise.

(9 marks)

You are a senior manager at Midway LLP, a busy medium-sized firm with three offices in the central counties of England and over 100 employees. The firm has been asked to tender for the provision of statutory audit and other services to Border Travel, a private limited, south coast based, company providing package coach holidays and short breaks in Scotland.

Border Travel has proven to be popular with pensioners but has also gained success in promoting group trips to stag and hen parties and corporate outward bounds clients. As a result the company is growing fast and would, if the tender is successful, provide a significant source of fee income for the firm. The finance director has explained that the company would like the successful firm to provide statutory audit services and assistance with the preparation of the financial statements. The company is also keen to improve its internal risk assessment procedures and would welcome an IT systems review. Your firm does not have much experience in the travel sector.

Required:

(b) With reference to the Code of Ethics, discuss the ethical matters that should be considered and the possible safeguards implemented when deciding on whether your firm should tender for:

(i) The statutory audit of Border Travel (5 marks)

(ii) The provision of other services to Border Travel. (6 marks)

(Total: 20 marks)

5 The directors of Lopit, a newly-formed company, have written to you with a view to securing your services as auditor. Within their letter, you note the following comments:

'Your duties and rights as auditor will be determined by the board of our company. In the main, these duties are in line with the usual legal requirements, but in the event of conflict or exclusion we will indemnify you against any legal action brought as a consequence of the position adopted. The board also retains the right to dismiss you at any time without necessarily disclosing the reasons for their action.'

Required:

(a) List and explain the duties of an auditor. (6 marks)

(b) Discuss the relationship between auditors and company directors? (2 marks)

(c) State the legal rights of an auditor of a limited company. (4 marks)

(d) Discuss whether directors have the authority to dismiss auditors? (2 marks)

(e) Explain the steps you would take prior to accepting the appointment as auditor to Lopit? (6 marks)

(Total: 20 marks)